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Division of the sources of Revenue between the Central Government and the Provincial Governments.

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(Meston Settlement.)

Pre-Reform Settlements.*

1833-70.

1. For several decades after the passing of the Charter Act of 1833, which vested the direction of the entire civil and military administration and the sole power of legislation in India in the Governor General in Council, the financial administration of India was completely centralised in the hands of the Government of India. Except for local cesses on land revenue, which are similar to the *centimes additionnels* in France, levied by some Provinces for roads, schools and other local services, Provincial Governments were entirely dependent on annual assignments from the Central Government for the maintenance of the administration. The Central Government had also complete control over the growth of Provincial expenditure, for their sanction was required for all proposals, however trivial the expenditure involved. It was not long before the defects and dangers of this highly centralised system became manifest. The local Governments, deeply interested in schemes for the welfare of the people entrusted to their care and ignorant of the requirements of other Provinces, or of India as a whole, were inclined, in their zeal for administrative progress, to press on the Central Government schemes, which in themselves deserved encouragement but which nevertheless had to be rejected on account of more urgent demands from other Provinces or on account of fiscal considerations. They were thus brought into frequent conflict with the Central Government, who were not in a position fully to understand local requirements and had not the requisite knowledge for a successful development of local resources. In these circumstances, the distribution of the public income, as Sir Richard Strachey has described in an oft-quoted passage, "degenerated into something like a scramble, in which the most violent had the advantage, with very little attention to reason ; as local economy brought no local advantage, the stimulus to avoid waste was reduced to a minimum, and as no local

*The account of the Pre-reform Settlements is based on

(1) The Report of the Royal Commission on Decentralisation,
(2) Financial Statements, 1870-78,
(3) Financial Statements, 1882-83, and
(4) Financial Statements, 1903-1911,
(5) Report on Indian Constitutional Reforms.

growth of the income led to local means of improvement, the interest in developing the public revenues was also brought down to the lowest level.'"*

Lord Mayo's scheme of decentralization, 1870-71.

2. To the Government of Lord Mayo, belongs the credit for initiating the first important measure of financial decentralization in India. In 1870-71 the Government of India made over to the Provincial Governments the administration of Jails, Registration, Police, Education, Medical Services, Roads and Buildings and Printing. To meet the cost of the administration of these provincialized services, there were assigned to the Provincial Governments the departmental receipts under the corresponding heads and also a fixed lump grant from Central revenues. Any additional expenditure on these services was to be met from savings on existing charges and by the imposition, where necessary, of local taxes. Provincial Governments were also given power to allot the revenues assigned to them at their discretion subject to certain financial rules and the Government of India ceased to scrutinise the Provincial estimates in detail.

Lord Lytton's scheme of decentralization, 1877.

3. This limited measure of decentralization was a success, both administratively and economically. The expenditure on the provincialised services, which had amounted to £6.03† millions in 1868-69, was reduced to £5.3 millions in 1877-78. The scheme, however, suffered from the defect that the services in which the Provinces were given a financial interest were relatively unimportant from the revenue aspect and Provincial Governments had no inducement to develop the revenue that they were raising from other sources. Important modifications were introduced in these Provincial settlements by the Government of Lord Lytton in 1877. Provincial responsibility in regard to expenditure was extended to certain other heads including land revenue, general administration, law and justice, while certain important heads of revenue, including stamps, excise and the license (now income) tax, were provincialised. Any increase over the revenues as they stood at the time of the settlements was to be shared with the Government of India, who were also to bear a share of any decrease. It was not, however, possible entirely to dispense with the fixed grants, except in the case of Burma and Assam, who were given a share of the land revenue in lieu of the fixed assignments.

With the extension of the financial functions of the Provincial Governments, however, scrutiny of Provincial receipts and expenditure became more detailed and the liberty of Provincial Governments to meet

*Sir John Strachey's India, 4th Edition, page 121.

†Speech by Lord George Hamilton on Indian Financial Statements in the House of Commons, 21st June 1877.

a deficit in current year's revenues by expenditure from Provincial balances was also curtailed.

Quinquennial settlements of 1882-1904.

4. In 1882 fresh settlements were made with the major Provinces, under which the allocation of revenue was briefly as follows :—

Central.	Divided equally between Imperial and Provincial.	Provincial.
Customs	Forest	Provincial rates.
Salt	Excise	Law and justice.
Opium	License tax	Public Works.
Posts and telegraphs	Stamps.	Education.
*Railways.	Registration.	
*Irrigation.		

The distribution of expenditure followed the incidence of revenue. Excess of Provincial expenditure over revenues was made up by assignments from the Central Government expressed as a percentage of the land revenue of each Province, which was otherwise a Central receipt.

In the subsequent quinquennial revisions, land revenue became definitely a divided head, while railways became almost entirely Central. An important feature of these revisions was the resumption of the Provincial surpluses at the end of the five-year period. In 1887 and 1892 the Central Government resumed Rs. 64† lakhs and Rs. 46 lakhs respectively.

Defects of the quinquennial settlements.

5. The system of quinquennial settlements was marked by several grave defects—

(1) In the first place, the periodical revisions interfered with the continuity of Provincial finance and each revision involved a protracted and sometimes controversial discussion with the Provincial Governments.

(2) In the second place, the system tended to encourage extravagance rather than economy. The policy of periodical resumption of Provincial surpluses (which was largely necessitated by severe financial pressure on the Government of India during the years of low exchange) destroyed any incentive in a Provincial Government to economise, since it knew that its reduced standard of expenditure would be the basis for a correspondingly unfavourable settlement at the next revision. The tendency was, therefore, to spend money not

*These heads were not entirely Central.
†Financial Statements, 1904-1905.

on carefully considered schemes of development but on such as could be carried through before the close of the settlement in order to leave as small a balance as possible for resumption at the impending revision.

(3) In the third place, the specific arrangements for the sharing of revenue and the allocation of expenditure varied from time to time in the different Provinces and there was no definite or logical principle underlying the apportionment.

The quasi-permanent settlements 1904-1911.

6. The quasi-permanent settlements of 1904 were intended partly to remove these defects and partly, as their name indicates, to introduce an element of permanence into the settlements. The general principles underlying these settlements were explained by Lord (then Mr.) Meston in his evidence before the Decentralization Commission of 1909. They are briefly as follows :—

(*a*) The Government of India retained certain administrative services which it was inexpedient to hand over to Provincial Governments and they reserved the revenues from those services and such a share of the other public revenues as was adequate to the expenditure falling upon them.

(*b*) The remaining administrative services of the country were entrusted to Provincial Governments, each of which received an assured income that was independent of the needs of the Government of India and sufficient for its normal expenditure.

(*c*) This income was given in the form of a definite share of the revenue which the Provincial Government collected in order that the Provincial Governments' resources might expand along with the needs of its administration.

(*d*) As far as possible, the same share of the chief sources of revenue was given to each Province to ensure a reasonable equality of treatment.

The revenues assigned to the Provinces under these settlements were definitely fixed and were not subject to alteration by the Government of India save in the case of a grave Imperial necessity or in the event of experience proving the assignments made to have been materially disproportionate to normal Provincial require-

*Lord Meston's evidence before the Decentralisation Commission.

ments. The division of the sources of revenue was roughly as follows :—

Central.	Heads generally divided equally.	Provincial.
Opium	Land revenue.	Registration.
Salt	Excise.	Police.
Customs ..	Stamps.	Education.
Mint	Income-tax.	Law and Justice.
Railways ..	Forests.	Medical.
Posts and Telegraphs	Major Irrigation	Minor Irrigation.
Tributes ..	....	Provincial Civil Works.

The difference between expenditure and income was made up by a fixed assignment under the land revenue head, but the Government of India aimed at making these assignments as small as possible, so as to enable each Province to derive the bulk of its resources from growing revenues.

Recommendations of the Decentralization Commission.

7. The problem of Provincial settlements was examined at some length by the Royal Commission on Decentralization in 1909, but no changes of a fundamental character were recommended. The Commission considered the possibility of a more definite separation between Imperial and Provincial finances by means of an arrangement under which the heads of revenue and expenditure which were divided would become wholly Provincial and the Government of India would receive contributions from each Province on the analogy of the *matrikular beitrage* of the German Empire. Three alternative methods by which such contributions might be made were considered—

(*a*) A fixed sum revisable every few years.

This was rejected as impracticable by the Commission on the ground that periodical revisions of the fixed assignments would provoke recurring controversies with the Provinces of the same character as those which it had been the object of the quasi-permanent settlements to avoid.

(*b*) A lump percentage on the Provincial revenues.

This was rejected on the ground that the percentage as between the various Provinces could not obviously be uniform, since the richer and more advanced would necessarily have to contribute a larger proportion of their revenues to the Central Government. Such percentages would, therefore, have to be arrived at by an examination

of the resources of each Province under each head and the system would not differ from the detailed Provincial settlements then in force.

(c) A fluctuating contribution imposed by the Government of India and calculated upon the population or the revenues of the different Provinces.

The Commission considered that a subsidy based on population or wealth or revenues would be unfair to the relatively poor and undeveloped Provinces while there was no method of assessing the comparative wealth of the various Provinces. A fluctuating contribution based on Provincial revenues would introduce an element of uncertainty into the Provincial finances and the position of these would be rendered worse.

The Commission approved of the system of divided heads, since under such an arrangement the Government of India would be more interested in and identified with Provincial Governments. They could also exercise control in matters of general policy with less friction, if they were also concerned pecuniarily. They advocated, however, the conversion of unduly large fixed assignments into shares of growing revenue even at the sacrifice of uniformity as regards the shares of divided heads as between the Provinces.

Permanent settlements of 1911.

8. When the quasi-permanent settlements were concluded with the various Provinces between the years 1904-1907, it was hoped that an element of stability in the relations between the Central Government and the Provincial Governments would be introduced, but almost before the work was finished a complete revision was found necessary in the case of the United Provinces and substantial re-adjustments were made in the settlement with Madras. Large subsidies had to be made to several Provinces, in some cases as a result of abnormally heavy famine expenditure and in others with no such justification. Burma suffered considerable inconvenience under its new settlement, while Bengal became almost bankrupt within a few years. The Government of India were not always in a position to enforce the obligations of the Provinces under the settlements, because the difficulties of some of the Provincial Governments were due to real defects in the settlements.

9. When the question of making permanent settlements with the Provinces was considered in 1910-11, the Government of

India made a very careful enquiry into the financial effects of the quasi-permanent settlements in order to satisfy themselves that they were suitable for confirmation in perpetuity. Since these permanent settlements were in force when the Reforms were introduced, it is important to know the precise procedure adopted by the Government of India in framing them. The method by which the adequacy of the settlements was tested is described below :—

The figures under each major head for the previous twelve years were carefully examined with special attention to the period which had elapsed since the conclusion of the last settlement. The figures of revenue and expenditure in the budget for 1910-11 were then scrutinised in detail, and abnormal items as far as possible eliminated. On this basis new standards of revenue and expenditure were assumed, and from them a hypothetical equating figure was deduced. The figure thus obtained was compared with the actual fixed assignment in the current year's budget. If the difference was not more than one per cent. on the provincial revenue, the calculations were taken as evidence that the settlement was adequate. If the difference was greater and the hypothetical equating figure was decidedly larger than the actual assignments, it was then assumed that the settlement was defective. These conclusions were checked with an entirely independent estimate of the working of each settlement which had previously been obtained from the Accountant-General of the province concerned. In the course of this examination, the normal rate of annual growth under each major head was calculated with reference to the actual figures of a selected normal year in the past and the corrected figures of the current budget. The aggregate rate of growth on each side of the account was then struck. If the yearly increment of expenditure was greater than the increment of revenue, and there was no evidence of serious improvidence, a case was considered to be established for commuting the

fixed assignments for a further share in growing revenue, to such extent as was necessary to secure an approximate equality between the two rates of growth.

10. The following statement shows the provincial shares of the principal heads of revenue and the corresponding expenditure under the permanent settlement :—

R=Revenue.
E=Expenditure.

Province.	Land Revenue.		Stamps.		Excise.		Assessed Taxes.		Forests.		Registration.	
	R.	E.	R.	E.	R.	E.	R.	E.	R.	E.	R.	E.
Madras	One-half	Whole ..	One-half	One-half	One-half ..	One-half ..	One-half	One-half	Whole ..	Whole ..	Whole ..	Whole.
Bombay	*Whole* of assessment of alienated lands less quit-rents and *half* of the other minor heads.	Whole ..	One-half	One-half	Whole ..	Whole ..	One-half*	One-half	Whole .	Whole .	Whole .	Whole.
Bengal	*Whole* of collections from Government estates and *one*-half of all other sub-heads.	Whole*	One-half	One-half	Three-fourths	Three-fourths	One-half	One-half	Whole .	Whole	Whole ..	Whole.
Eastern Bengal and Assam.	One-half*	Whole*	One-half	One-half	Whole ..	Whole ..	One-half	One-half	Whole .	Whole ..	Whole .	Whole
United Provinces ..	Three-eighths*	Whole ..	One-half	One-half	Three-fourths	Three-fourths	One-half	One-half	Whole .	Whole .	Whole .	Whole.
Punjab	One-half	Whole ..	One-half	One-half	One-half ..	One-half ..	One-half	One-half	Whole .	Whole ..	Whole ..	Whole.
Burma	Five-eighths	Whole ..	One-half	One-half	One-half ..	One-half ..	One-half	One-half	Whole ..	Whole ..	Whole ..	Whole.
Central Provinces ..	One-half	Whole ..	One-half	One-half	Three-fourths	Three-fourths	One-half	One-half	Whole ..	Whole ..	Whole ..	Whole.

* With certain minor exceptions.

Tendencies in the development of fiscal relations.

11. The history of the earlier settlements has been given in some detail, because it is not generally realised that some of the suggestions that have been made during recent years for the modification of the Meston Settlement had been carefully examined and rejected by the Government of India or by expert bodies such as the Royal Commission on Decentralization. It may be useful at this stage to summarise the salient features of the last of the pre-Reform settlements and the tendencies in the development of the fiscal relations between the Government of India and the Provincial Governments—

(1) The settlements were based primarily on the estimated needs of individual Provinces and not on Provincial revenues. The point is rather important, since, in determining the initial Provincial contributions, the Meston Committee took into consideration only the increased spending power that was expected to result from their scheme of redistribution and practically ignored the requirements of the Provinces.

(2) The income from the divided heads of revenue was still supplemented by special contributions, both recurring and non-recurring, out of the Central Government's surplus revenues. In fact, the special contributions were larger than in the period when the quasi-permanent settlements were in force.

(3) Though the intervention of the Government of India in the preparation of Provincial budgets was considerably curtailed, there was no relaxation of the control over taxation. Control over Provincial expenditure also continued and, in fact, was inevitable under a system of financial settlements based on Provincial requirements.

(4) Although the Government of India laid down the principle (endorsed by the Decentralization Commission) that the same share of the chief sources of revenue should be given to each Province to ensure a reasonable equality of treatment, there was no uniformity as regards the percentage of each head of revenue allotted to the Provinces. For instance, while Madras, the Punjab and Burma got only one-half of the excise revenue, Bengal, the United Provinces and the Central Provinces got three-fourths and the

other Provinces the whole. The point is important, for, as the following statement shows, the growth of revenue between the years 1912-13 to 1920-21 in the different Provinces was very unequal :—

Percentage of growth between 1912-13 and 1920-21 under the principal heads of revenue.*

Province.	Excise.	General Stamps.	Land Revenue and other Provincial heads.	All Provincial heads.
Madras	70·24	63·22	11·66	29·06
Bombay	102·57	119·13	32·00	52·43
Bengal	35·91	69·49	13·52	22·30
United Provinces ..	43·70	45·75	17·13	20·82
Punjab	106·78	73·73	26·86	34·88
Burma	36·15	26·62	33·52	33·65
Bihar and Orissa ..	24·20	55·29	4·53	11·20
Central Provinces ..	49·00	48·25	26·30	33·18
Assam	44·26	22·22	20·60	28·00
All the 9 provinces ..	62·27	69·24	20·98	30·48

* (See paragraph 7 of the Report of the Financial Relations Committee).

Montagu-Chelmsford Reforms.

12. The next phase of development in the financial system of India comes with the introduction of the Montagu-Chelmsford Reforms of 1919 and it now becomes necessary to link financial history more closely with certain salient features of the constitutional problems which then arose and still continue. The nature of the problems, constitutional as well as financial, which His Majesty's Government had to deal with in 1917, and the views of the authors of the Report on Indian Constitutional Reforms, as to the changes which they sought to bring about in pursuance of the policy enunciated by His Majesty's Government are summed up in paragraph 120 of the Report which is here quoted—

> "We have dealt at some length with the strong tie which binds the provinces to the central government. It seemed to us necessary to analyse it, because it constitutes the chief obstacle across our path, and also affords a plain warning to those who are disposed to be misled by facile analogies from federal constitutions. Granted the announcement of August 20, we cannot at the present time envisage its complete fulfilment in any form other than that of a

congeries of self-governing Indian provinces associated for certain purposes under a responsible Government of India ; with possibly what are now the Native States of India finally embodied in the same whole, in some relation which we will not now attempt to define. For such an organization the English language has no word but 'federal'. But we are bound to point out that whatever may be the case with the Native States of the future, into the relation of provincial and central governments the truly federal element does not and cannot enter. There is no element of pact. The government of the country is at present one ; and from this point of view the local Governments are literally the 'agents' of the Government of India. Great powers have been delegated to them, because no single administration could support the Atlantean load. But the process before us now is not one of federalising. Setting aside the obstacles presented by the supremacy of Parliament, the last chance of making a federation of British India was in 1774, when Bombay and Madras had rights to surrender. The provinces have now no innate powers of their own, and therefore have nothing to surrender in a *foedus*. Our task is not like that of the Fathers of the Union in the United States and Canada. We have to demolish the existing structure, at least in part, before we can build the new. Our business is one of devolution, of drawing lines of demarcation, of cutting long standing ties. The Government of India must give and the provinces must receive : for only so can the growing organism of self-government draw air into its lungs and live. It requires no great effort of the imagination to draw a future map of India which shall present the external semblance of a great new confederation within the Empire. But we must sedulously beware the ready application of federal arguments or federal examples to a task which is the very reverse of that which confronted Alexander Hamilton and Sir John Macdonald."

13. While it is necessary, as has been suggested in the passage quoted above, to beware of facile analogies from federal systems, nevertheless it may be pointed out that there are certain general principles underlying the fiscal systems of all civilised

countries which are of universal application and also that the problem of the financial relations between a federal authority and its component states can usefully be compared with the problem of the financial relations between the Central Government and Provincial Governments in India. The former problem is one which has arisen frequently during the last century, and in the history of the United States, Switzerland, Germany, Canada, Australia and South Africa, there are a number of practical examples of the way in which it has been approached. Before the important changes in the financial machinery of India introduced with the Reforms are described, it may therefore be useful to examine the principles on which the fiscal systems of these federations are based.

Financial systems of certain federations.

14. An account in some detail of the fiscal relations between the federal government and the component states in the six countries referred to in the last paragraph is given in Appendix I. It will be observed that there is very little similarity between the systems that have been evolved in the different federations, and that the distribution of resources between the federal government and the component states is not based upon theoretical principles. This is not surprising, for, as has been observed by the Taxation Committee, the systems adopted by different countries have been "moulded by widely differing influences emanating from the past history of the particular states, the psychology of their people, the religious differences prevailing among them and their trade and foreign relations with other states". The salient features of these systems, which may be of interest in the consideration of the Indian problem, are briefly summarised below :—

(1) It will be observed that it is almost the invariable rule that customs duties, including export duties, and excise duties are exclusively in the hands of the central Government and this is true even of those federations where the federal authority is weakest. This arrangement involves freedom of inter-State trade and its control by the central authority and in all cases the desire to secure such freedom of inter-State trade has been one of the principal motives for federation. The principle has been held to necessitate a degree of interference by the Central Government, which has yet to be realised in India. Thus in the United States, it has been held to involve central control of navigable waters in States which

are accessible from other States, to rule out taxation by local authorities of imported articles while in their original packages and to bar State taxation on gross receipts of railways and steamship companies operating beyond the State and on passengers landing from steamships.

(2) In most of the federations no attempt has been made completely to separate the sources of revenue of the federal Government and the constituent States, nor is such a separation considered essential in order to ensure the fiscal autonomy of the States.

(3) Income-tax was generally regarded as a source of State revenue, but the recent experience of some of the federations has shown that in practice the raising of considerable sums through an income-tax can only be done on a national scale. In the United States of America, Australia and Canada, the federal Governments abandoned their previous reliance on indirect taxation and imposed direct taxes as soon as an emergency arose. In most of the federations, income-taxes are now levied both by the federal Government and by the constituent States. In Germany and Switzerland, income-taxes are administered by the Provinces but the control is federal.

(4) Subsidies from the Central Government to the constituent States or Provinces are a normal feature of many of the federal constitutions.

Meston Settlement.

15. The history of the Provincial settlements will now be resumed. The permanent settlements of 1911 continued to be in force until the introduction of the Reforms, and to understand the nature of the new settlements, it is necessary briefly to refer to the constitutional changes, which necessitated a radical change in the system of finance.

Principles underlying the constitutional changes.

16. The ideal to which, in the view of the authors of the Report on Indian Constitutional Reforms, the political development of India will probably tend in the future has already been described. The fundamental principle on which their proposals are based is that the Provinces should be given "the largest measure of independence, legislative, administrative and financial of the Government of India which is compatible with the due discharge by the latter of its own

responsibility ". As has been observed, the pre-Reform settlements were based not on Provincial revenues but on Provincial needs and the Government of India were responsible for Provincial solvency. This inevitably led to central control over Provincial expenditure, and since the Government of India took a percentage of the proceeds of certain taxes, they had a direct motive for interfering in the details of administration. The Government of India had also complete control over all taxation imposed in British India, apart from the local taxes raised by local authorities. The authors of the Report held that a system which had worked successfully between two official governments would be quite impossible between a popular and an official government. Their first aim was, therefore, to find some means of entirely separating the resources of the Central and the Provincial Governments. If responsible Government in the provinces was to mean anything real, clearly the Provinces must not be dependent on the Central Government for the means of provincial development, and their idea was that an estimate should first be made of the scale of expenditure required for the upkeep and development of the services which clearly appertain to the Central sphere, that resources with which to meet this expenditure should be secured to the Central Government and that all other revenues should then be handed over to the Provincial Governments which would thenceforth be held wholly responsible for the development of all Provincial services. They thus started with the axiom that a complete separation of the sources of revenue is necessary. It may be pointed out, however, that Provincial Governments also pressed very strongly for complete separation owing to the trouble which they had had in connection with the system of divided heads. The constitutional changes contemplated* by the authors of the Report involved on the financial side the grant of all residuary powers to the Provinces. The system which was actually embodied in the Government of India Act and its Rules did not however go so far as this.

Division of Sources suggested in the Report.

17. The detailed arrangements for the division of the heads of revenue and the arguments by which they were supported by the authors of the Report are summarised below :—

(1) Stamps were to be Central, since it was obviously desirable to avoid discrepancies of rates in the case of commercial stamps, while court-fee stamps were to be a Provincial source of revenue and were regarded as an

*Paragraph 201 of the Montagu-Chelmsford Report ; but the Report itself is not consistent on this point, *vide* paragraph 210.

additional means by which the Provinces could augment their resources.

(2) Excise was made Provincial, since it was already a Provincial head in Bombay, Bengal and Assam and there was no valid reason why it should not be made Provincial throughout India.

(3) Land revenue and irrigation were both assigned to the Provinces, chiefly because their assessment and collection were very intimately concerned with the whole administration in rural areas. This involved the transfer to Provincial Governments of the entire liability for expenditure on famine relief and protective irrigation works.

(4) As regards the income-tax, the authors saw two very strong reasons for making it Central. The first was the necessity for maintaining a uniform rate throughout the country because of the inconvenience, particularly to commerce, of having different rates in different Provinces. In the second place, in the case of ramifying enterprises with their business centre in some big city, the Province in which the tax is paid is not necessarily the Province in which the income was earned. The authors clearly recognised that provincialisation of land revenue and centralisation of income-tax would mean the grant of an initial advantage to Provinces whose wealth was predominantly agricultural over those which had large commercial and industrial interests. They would not, however, allow this consideration to stand in the way of a complete separation of resources, for they held that absolute equality of treatment as between the Provinces is not a *sine qua non* and that the aim could only be to reach equality so far as this is possible in the settlement as a whole.

System of contributions

18. In order to meet the resultant deficit in the Central budget, they proposed, as a transitional measure, a system of contributions from each Province to the Central Government assessed on the normal surplus of the Provinces, *i.e.*, the difference between the estimated gross revenue under the new scheme and the estimated normal expenditure. The deficit of the Central Government was estimated at Rs. 13,63 lakhs and the Provincial contributions were calculated

as shown in the following statement :—

(In lakhs of rupees).

Province.	Gross Provincial revenue.	Gross Provincial expenditure.	Gross Provincial surplus.	Contribution (87% of column 4).	Net Provincial surplus.
1	2	3	4	5	6
Madras	13,31	8,40	4,91	4,28	63
Bombay	10,01	9,00	1,01	88	13
Bengal	7,54	6,75	79	69	10
United Provinces ..	11,22	7,47	3,75	3,27	48
Punjab	8,64	6,14	2,50	2,18	32
Burma	7,69	6,08	1,61	1,40	21
Bihar and Orissa ..	4,04	3,59	45	39	6
Central Provinces ..	4,12	3,71	41	36	5
Assam	1,71	1,50	21	18	3
Total ..	68,28	52,64	15,64	13,63	2,01

19. These proposals led to very strong protests from the Governments of the United Provinces and Madras and they were examined at great length by the Government of India, whose views are stated in paragraphs 56—61 of the First Despatch on Indian Constitutional Reforms. The Government of India were prepared to accept these proposals in general, but in view of the strength of the feeling that had been aroused, they strongly recommended that the whole question should be enquired into by a special committee on financial relations. This recommendation was endorsed by the Joint Select Committee of Parliament.

Meston Committee's recommendations.

20. The report of this committee, commonly known as the Meston Committee is the basis of the present Provincial settlements. The Committee were specifically directed to advise on—

(*i*) the contributions to be made by the various Provinces to the Central Government for the financial year 1921-22,

(*ii*) the modifications to be made in the Provincial contributions thereafter with a view to their equitable distribution until there ceases to be an All-India deficit, and

(*iii*) the question whether the Government of Bombay should retain any share of the revenue derived from income-tax.

The recommendations of the Meston Committee are summarised below :—

(*a*) In order to avoid the system of doles and to facilitate the initial distribution of the Central deficit, the Committee recommended that general stamps should be made a Provincial head throughout India instead of Central as proposed in the Report on Indian Constitutional Reforms.

(*b*) On the question of the division of income-tax, which was specifically referred to them at the instance of the Government of Bombay, they recommended that the whole of the income-tax proceeds should be credited to the Central Government, though they doubted whether it would be possible permanently to exclude local Governments from some form of direct taxation upon the industrial and commercial earnings of their people.

(*c*) On the question of initial contributions to the Central Government, they suggested a distribution on a principle somewhat different from that underlying the scheme proposed in the Montagu-Chelmsford Report. They pointed out that the latter scheme stereotyped existing disparities of contribution and that the figures suggested by the authors of the Report were based on the figures of normal surpluses, *i.e.*, the excess of normal revenue over normal expenditure. While there was general agreement as regards the figures of normal revenue, the estimates of normal expenditure in each Province were very strongly contested. Any such scheme based on actual figures would penalise those Provinces which had economised during the War. Moreover, it was exceedingly difficult to say to what extent expenditure held over during the War but clearly impending ought to be included in the calculations. It was also necessary to make allowance for the special conditions of undeveloped Provinces like Burma or recently established Provinces like Bihar and Orissa. In short, the basis adopted by the authors of the Report was artificial and temporary.

The Committee therefore proposed to assess the initial contributions on the increased spending power of the Provinces, *i.e.*, the additional resources which a Province would acquire on the separation of the sources of revenue. This proposal was less open to attack, since there was general agreement as regards the figures of normal revenue. The Committee also suggested an elaborate formula under which the contributions by the Provinces would be reduced over a term of seven years to figures which were based on an estimate of the taxable capacity of the Provinces. It

is important to observe that in fixing initial contributions, Burma, Bihar and Orissa, the Central Provinces and Assam were given exceptional treatment. The recommendations of the Committee are set out in the following statement.

(In lakhs of rupees).

Province.	Increased spending power under new distribution of revenues.	Contributions as recommended by the Committee.	Increased spending power left after contributions are paid.
Madras	5,76	3,48	2,28
Bombay	93	56	37
Bengal	1,04	63	41
United Provinces ..	3,97	2,40	1,57
Punjab	2,89	1,75	1,14
Burma	2,46	64	1,82
Bihar and Orissa ..	51	*Nil*	51
Central Provinces ..	52	22	30
Assam	42	15	27
Total ..	18,50	9,83	8,67

Report of the Joint Select Committee.

21. The Meston Committee's Report was examined by the Joint Select Committee of Parliament on draft rules made under the Government of India Act. They saw no reason to differ from the fundamental features of the proposals and were definitely opposed to the provincialisation of income-tax. Nevertheless, they stated that on grounds of policy an attempt should be made to alleviate the disappointment caused by the restraints which the system of contributions lays on the employment by the Provinces of their revenues. They accepted the suggestion proceeding from the India Council " that there should be granted to all Provinces some share in the growth of revenues from taxation on income so far as that growth is attributable to an increase in the amount of income assessed ". They, however, rejected the proposal of the Meston Committee as regards the standard contributions and recommended that the contributions should be entirely abolished as soon as the financial position of the Government of India permitted them to do so. The manner in which the share of the income-tax was to be assessed was indicated in Devolution Rule 15, which, as finally amended, runs as follows :—

"Whenever the assessed income of any year subsequent to the year 1920-21 exceeds in any Governor's Province or in the Province of Burma the assessed income of the year 1920-21, there should be allotted to the local Government of that Province an amount calculated at the rate of three pies in each rupee of the amount of such excess."

Present distribution of the sources of revenue.

22. The actual distribution of the sources of revenue which is at present in force under the Government of India Act may now be specified. This distribution is regulated by the Devolution Rules—

(1) Rule 3 provides that, for the purpose of distinguishing the functions of the local Government from the functions of the Governor General in Council, subjects shall be classified in relation to the functions of the Government as Central and Provincial subjects in accordance with the lists set out in Schedule I.

Provincial sources of revenue.

(2) Rule 14 specifies the sources of Provincial revenue. The items which are of importance here are—

(*a*) Receipts accruing in respect of Provincial subjects which include irrigation, land revenue, forests, excise, alcoholic liquor and intoxicating drugs, non-judicial and judicial stamps, registration and minerals. (Provincial subjects include also sources of Provincial revenue from taxes which were imposed by or under Provincial legislation which had received the previous sanction of the Governor General—item 48, List of Provincial subjects).

(*b*) A share (to be determined in the manner provided for by Devolution Rule 15 (1) quoted in the last paragraph) in the growth of revenue derived from income-tax collected in the Province so far as that growth is attributable to an increase in the amount of income assessed.

(*c*) The proceeds of any taxes which may be lawfully imposed for Provincial purposes.

These include the following taxes specified in Schedule I to the Scheduled Taxes Rules :—

1. A tax on land put to uses other than agricultural.
2. A tax on succession or on acquisition by survivorship in a joint family.
3. A tax on any form of betting or gambling permitted by law.
4. A tax on advertisements.
5. A tax on amusements.
6. A tax on any specified luxury.
7. A registration fee.
8. A stamp-duty other than duties of which the amount is fixed by Indian legislation.

(*d*) Any other sources which the Governor General in Council may by order declare to be sources of Provincial revenue.

Central Sources of Revenue.

(3) The sources of revenue allotted to the Government of India are not specified, but the subjects classified as Central include the following :—

Customs, income-tax, salt, Posts and Telegraphs, Railways, control of cultivation and manufacture of opium and sale of opium for export.

The list of Central subjects also contains a clause reserving to the Central Government all other matters not included among Provincial subjects under Part II.

Developments since the Reforms.

Criticism of the new Settlements.

23. From the outset the new settlements were subjected to very severe criticism by the provincial governments, in particular by Madras, Bombay and Bengal. It had been hoped that the resources of the provinces, increased as a result of the new financial settlement, would enable them to find money for large schemes of economic and social development, but unfortunately so far from being available for the development of nation-building services, the surpluses had had to be devoted to increases of salary which had become necessary on account of the enormous rise in prices from which India, in common with other countries of the world, had for some years after the War been suffering. The situation was aggravated by the campaign for the introduction of prohibition, which exercised a baneful effect on the excise revenue. The Madras Government protested very strongly against the grave injustice done to it by the demand of an

annual contribution of 348 lakhs for Central purposes and stated that unless the financial embarrassments resulting from this huge contribution were removed, there would be no development of the services entrusted to the Ministers. Bombay and Bengal demanded a complete revision of the whole settlement, without which it was urged a satisfactory working of the Act of 1919 was impossible. The case of Bengal had been recommended to the special consideration of the Government of India by the Joint Select Committee on the Government of India Act. The Government of India, after a detailed and critical examination of the financial position of Bengal, came to the conclusion that with every economy Bengal must have a deficit of not less than Rs. 120 lakhs, even if it provided only the bare minimum expenditure required to carry on the administration of the province and no allowance was made for any extra expenditure on improvements in transferred subjects which were urgently desired by the Ministers. In 1921, on the recommendation of the Finance Member, the Legislative Assembly agreed to the remission of the Bengal contribution for a period of three years from 1922-23. This concession intensified the protest from other provinces against the contributions. Any further remission of these contributions, however, was for the time being out of the question owing to the financial difficulties of the Central Government. On the other hand, the fact that the estimated revenues and expenditure of all the local governments, except Bengal and Burma,* for the year 1922-23 revealed a deficit could not be ignored, and with the consent of the Government of India the Conference of Finance Members held in Simla in April 1922 reviewed the whole position. Various proposals for dealing with the problem were discussed, among which may be mentioned a suggestion by the Bombay representatives that a reversion to the system of divided heads might be considered. A complete separation of the sources of revenue was, however, regarded by all other provincial representatives as the basis of the whole scheme of Reforms and the Government of India, with the concurrence of the Secretary of State, decided to uphold the new financial settlement, but repeated the undertaking given earlier that the existing financial contributions would be abolished as early as possible.†

Reforms Enquiry Committee's Report.

24. The problem was also considered by the Reforms Enquiry Committee in 1924, but in the absence of any definite information upon which recommendations for a

*Excluding expenditure from rice profits.

†See "India in 1922-23, page 105".

revision of the settlement could be based, this committee merely recommended that the settlement should be revised as soon as a favourable opportunity occurred.

Taxation Enquiry Committee's Report.

25. The question was also examined at great length by the Taxation Enquiry Committee, whose conclusions are briefly summarised below :—

(*a*) Non-judicial stamps and the excise duty on country-made foreign liquor should be transferred to the Central Government.

(*b*) The revenue from the excise on opium should similarly be Central.

(*c*) The export duties might possibly be used as a balancing factor but should be employed only in the last resort.

(*d*) The Provinces should be given the proceeds of a basic rate on personal income graduated proportionately to the general rate, to which should be added a small proportion of the receipts from the super-tax on companies.

It was not one of the functions of the Committee to suggest a detailed settlement between the Government of India and the Provinces and they, therefore, left the application of the principles suggested by them to some other body. These proposals will be discussed at some length in a subsequent portion of this Memorandum, but to complete the narrative a brief account of the action taken by the Government of India on these recommendations may be given here.

Subsequent discussions.

26. Owing to administrative and other difficulties which the change would involve, the Government of India rejected the recommendation to centralise the excise on opium and the excise duty on country-made foreign liquor. They were prepared to agree to the centralisation of non-judicial stamps, but, owing to the strong objections of the provincial governments to the proposal, it was ultimately suggested that only commercial and quasi-commercial stamps should be centralised. This proposal has been accepted by the provincial governments on the condition that adequate compensation is given to them in some other form. As regards the division of income-tax, the Government of India suggested that the provinces should be given a share of the income-tax calculated at the rate of 3 pies in the rupee on personal incomes from all sources of assessees

resident within each province. These proposals were discussed with the Financial representatives of the provinces at the Conferences held in November 1926 and 1927, but no agreement was arrived at and it was ultimately decided that the revision of the Meston Settlement should await the deliberations of the Statutory Commission.*

Final extinction of contributions.

27. In the meantime the financial position of the Government of India after 1923 improved sufficiently to enable the provincial contributions to be gradually reduced and they have been finally wiped out in the current year.

The Meston Settlement in operation.

28. The present distribution of resources may be considered from two points of view :—

(1) That of the Government of India, and

(2) that of the Provincial Governments.

Meston Settlement from the point of view of the Central Government.

It will be observed that under the present scheme of distribution, the Central Government holds in its hands, in the shape of the income-tax, the only real instrument of progressive taxation at present used in India. It also imposes all the principal consumption taxes except those on liquor and drugs. It therefore has power to reach with its taxation practically all classes of the population and to tax them in accordance with their ability to pay. The only important section which escapes is that composed of the richer agriculturists who have been exempt from the income-tax since 1872. It might be inferred from this that the revenues of the Central Government under the present allocation are sufficiently elastic and adequate, at any rate so far as its normal requirements are concerned. But, as will be observed from the brief outline of its financial history given below, the Central Government was not free from grave financial embarrassments for several years after the introduction of the Reforms. Indeed it has been argued that the present division of resources has left the Government of India with revenues of an embarrassingly fluctuating nature, and in support of this view it has been pointed out that at a time of trade depression it was necessary to hamper trade by heavy increases in customs duties.

The Financial position of the Central Government.

29. For three years before 1921-22, when the first budget under the reformed constitution was presented to the Legislative Assembly, the accounts of the Government of India had revealed deficits

*A copy of the correspondence with Provincial Governments on the division of income-tax and general stamps and extracts from the proceedings of the conferences on these proposals is given in Appendix II.

amounting in all to Rs. 55 crores. The budget of 1921-22 also anticipated a deficit of Rs. 18 crores and additional taxation, which was mostly under customs duties, had to be imposed. This included an increase of the general *ad valorem* duties from 7½ per cent. to 11 per cent., and a special duty of 20 per cent. on luxuries. It was hoped that these additional taxes would give a small surplus, but unfortunately, owing to the very acute trade depression throughout the world, the failure of the monsoon in India, and various other factors, not only was the surplus not realised but there was a deficit of Rs. 28 crores. The additional taxation imposed during the following year included an increase in the rates of income-tax and super-tax, in the general customs duties and in the duty on sugar, machinery, matches and articles of luxury. Railway rates were also raised. Yet, in spite of these fresh levies, there was no promise of financial equilibrium and the Government had to decide to budget for a deficit of Rs. 9 crores in 1922-23.

30. The serious financial difficulties of the Central Government gave rise to a general and insistent demand for retrenchment and a committee, commonly known as the Inchcape Committee, was appointed in the latter part of 1922. The Committee made a minute and searching scrutiny of the expenditure of every department of the Central Government and in its report submitted in March 1923 recommended reductions amounting in all to Rs. 19¼ crores in the expenditure of the Central Government. The major portion of the proposals of the Committee were given effect to in the budget for 1923-24, but it was of course impossible to obtain the full value of the proposed reductions in the first year. Notwithstanding the heavy all-round increases in taxation during the previous year and the drastic economies in expenditure affecting both civil and military services, the preliminary estimates for 1923-24 again revealed a deficit, and it was considered necessary to double the duty on salt. The Legislative Assembly did not consent to the proposed imposition and the Finance Bill, including the increased salt duty, had to be certified by the Viceroy.

31. The actual outturn of the year 1923-24 was a surplus of Rs. 2.4 crores and since then there have been recurring surpluses, which have been utilised partly for the reduction of taxation and partly for reducing the provincial contributions. The salt duty was reduced in 1924-25 to Rs. 1-4-0 per maund from the temporary figure of Rs. 2-8-0 in 1923-24, the cotton excise duty was abolished in 1925-26, and the export duty on tea and the import duty on machinery in 1927-28. The provincial contributions were gradually reduced and

have been finally extinguished in the current year. These financial achievements, however, cannot be entirely attributed to the growth in the normal tax-revenue of the Central Government, for they have been rendered possible, partly at any rate, by alterations in the customs tariff and the imposition of various special protective duties. There are two other factors which have to be weighed in estimating the sufficiency of the resources of the Central Government for its ordinary requirements. In the first place, as will be shown in the succeeding passage of this Memorandum, the present scale of taxation is held by a certain body of opinion to be still unduly high. Secondly, with the loss of the residue of the provincial contributions the budget for 1928-29 only just attains equilibrium : and it remains to be seen not only whether this particular estimate can be realised, but further whether taxation even if maintained on the existing scale is capable of yielding the further increase which will be required to keep pace with the necessary growth of central expenditure on national services.

32. The financial position of the Central Government must be considered from another standpoint also. It is liable to suffer more from external troubles and serious economic crises than Provincial Governments, and it has also to be prepared to sustain the financial burden of certain specially serious emergencies such as war. The question therefore arises whether the present allocation of revenues provides a sufficient margin for such emergencies. The principal taxes on which the Central Government depends are, as has been stated,

(1) the income-tax,

(2) customs duties, and

(3) the salt tax.

It was to these sources of revenue, as well as railway rates, that the Central Government in India, as in many other countries, had to turn in order to secure financial equilibrium after the Great War ; and in recent years it has not been possible to make any reduction in the level of taxation from incomes and customs then reached. Should a similar emergency arise, the Central Government in India will be compelled to have recourse to the same sources for additional funds, however distasteful such a course may be to the public, and it will be particularly distasteful, if the emergency so far as India is concerned is the result of decisions in which their representatives have had no voice. It has, however, been held by certain authorities that even so, the extra revenue which could be raised by increasing existing direct and indirect Central taxation is dangerously inadequate.

The income-tax in India has, so far, not proved to be as elastic a source of revenue as it is in other countries. Direct taxation on income is exceedingly unpopular among the Indian trading and professional classes, and moreover the task of accurate assessment—without which a high graduated rate of income-tax can hardly be justified—has always presented great difficulties in the peculiar conditions of India. It is only during the last five or six years that the law has been modernised and an increasingly efficient administrative machinery for the assessment and collection of the tax has been organised. But even so, owing to trade depression, the yield of the tax has shown a progressive falling off in the last four years, and the process of accustoming the public to this tax could not have been carried through without serious friction being engendered if the rates had been periodically enhanced. Certain authorities accordingly hold that the tax is one which, at any rate for some years to come, can hardly be raised to meet emergencies. There has also been no decrease in the rates of income-tax and super-tax after the War, which still stand at as high a level as they have ever stood in India.

The yield of customs taxation has increased in the last four years by about Rs. 9 crores, of which about Rs. 1½ crores is estimated to be derived from protective duties. It has been held by certain authorities that the general rate of customs duties, which is now 15 per cent., is far too high for a revenue tariff and is in several cases positively damaging in its effects; that the general level of customs tariff cannot be left unreduced much longer without serious injury to India's economic interests; and that any really large net increase in the present level of customs taxation in India for the purpose of a future war is out of the question, while even if it were possible the yield would be precarious.

It has accordingly been urged that now that the provincial contributions have been abolished, the Central Government must begin the process, which has had perforce to be postponed hitherto, of effecting such reductions of Central taxation as will begin to give India a reasonable margin of taxable capacity on which the Central Government can rely in an emergency such as another war. On the other hand, it has been argued that the maintenance of taxation from incomes and customs substantially at the present level, with the object of making more money available for outlay on beneficial developments of all sorts in the provinces, will, in itself, lead to the growth of a new generation with greatly increased taxable capacity fitted to bear the fiscal burdens which a war entails. Both aspects of the

question will require careful consideration in connection with any proposal which is directed to transferring to Provincial Governments any substantial portion of the revenues from taxation now at the disposal of the Central Government by maintaining that taxation at about its present level.

Meston settlement from the point of view of the Provincial Governments.

33. From the point of view of Provincial Governments, the scheme of distribution of revenues has been subjected to very severe criticisms by all the Governments concerned, though these have not always proceeded on the same lines and in many cases were mutually opposed. The arguments urged against the scheme may be classified under six heads—

(*a*) that the provincial contributions to the Central Government fixed by the Meston Committee were not equitable as between the different provinces,

(*b*) that the provincial revenues are inelastic,

(*c*) that the distribution does not enable the provinces to evolve a system of provincial taxation based on the principle of ability to pay,

(*d*) that in the allocation of revenues the requirements of the provinces should have been taken into consideration,

(*e*) that Devolution Rule 15, which was intended to secure to the large industrial provinces a share in the growing revenue from taxation of incomes, has completely failed in its purpose, and

(*f*) that the annual contributions of certain provinces to the Famine Insurance Fund have been pitched too high.

34. The principal criticisms against the Meston contributions were that the predominantly agricultural provinces were compelled to pay to the Central Government a disproportionately large portion of the proceeds of provincial taxation and that in assessing the contributions on the increased spending power of the provinces, the Meston Committee did not take into consideration the fact that, under the permanent settlement of 1911, the proportion of revenues assigned to each province was not uniform and that the growth of provincial revenues during the period 1911 to 1920 was, as the statement in paragraph 11 shows, very unequal. Even after the contributions have been extinguished, the inequality of the allocation remains; and this feature of the settlement is dealt with elsewhere. But it is unnecessary to discuss further the actual contributions or their prospective amounts, since they have ceased to exist and will not be revived, at any rate

in the form in which they were cast by the Meston Committee.

35. So far as the elasticity of provincial revenues is concerned, it will be observed that the income of the Provincial Governments under the present scheme is mainly derived from two sources,—land revenue and excise. Owing to historical reasons, the system of land revenue assessment has developed on different lines in the different provinces. Bengal, Bihar and Orissa and a large portion of Madras have had the Permanent Settlement, while elsewhere the assessment is subject to periodical revision. The abolition of the Permanent Settlement, it is contended, is hardly within the range of practical politics, and it has been argued that it cannot be justified even from the point of view of economic theory. For instance, in Bengal, it is stated, that 90 per cent. of the estates have changed hands and whatever unearned increment accrued on account of the permanency of the settlement has already been absorbed in the purchase price. The abolition of the Permanent Settlement would therefore penalise the present owner of the land for the benefits derived by the original owner. So far as those provinces are concerned, therefore, it would seem that there is no possibility of any appreciable increase in the revenue from land. Even in temporarily settled lands, the revenue has shown very little sign of elasticity during recent years. As the Taxation Enquiry Committee has pointed out in paragraph 92 of its report, during the period 1903 to 1924, while prices rose by 117 per cent. the land revenue rose by only 20 per cent. and a portion even of this rise was due to an increase of 7 per cent. in the area sown. This is partly due to the policy of moderation that has been followed since Lord Curzon laid down the general principles on which revisions of assessment should be made.

As regards excise, there has been a greater uniformity in policy, but, owing to the fact that liquor is prohibited by religion or social usage in certain communities, its consumption—and consequently the revenue—varies enormously in the different provinces. While the income from excise in Madras, with a population of 42 millions is Rs. 5 crores and in Bombay, with a population of 19 millions is Rs. 4¼ crores, the revenue from excise in Bengal, with a population of 47 millions is only Rs. 2¼ crores. Moreover if present political tendencies towards prohibition continue, the revenue from this source is more likely to decline than to increase.

36. The third criticism raises an issue of fundamental importance, and it is directed against the whole system of separation of

the sources which has been applied to India. It is pointed out that under the present system it is almost impossible for the provinces to levy their taxation according to the principle of ability to pay or the taxable capacity of their inhabitants. As the authors of the Report on Indian Constitutional Reforms remarked, the income-tax " is merely the industrial or professional complement of the land revenue and to provincialise the latter while Indianising the former means giving those provinces whose wealth is more predominantly agricultural, such as United Provinces and Madras, an initial advantage over a province, like Bombay which has very large commercial and industrial interests ". In the case of a Province, such as Bombay, a large proportion of whose annual income is derived from industry and commerce, Provincial revenues under the present system can have little relation to the taxable capacity of the inhabitants. Moreover when an important section of the population is removed from the fiscal sphere of the Province, it becomes exceedingly difficult to justify an increase of provincial taxation. This aspect of the matter has not so far attracted much attention owing to the fact that there has been no marked rise in the level of provincial taxation since the Reforms. But as taxation becomes heavier, the more insistent will be the demand that it should be based on the taxable capacity of the different classes, and it is conceivable that, if the present system continued, a province might find itself obliged to choose between the abandonment of further development or the enforcement of an objectionable system of taxation, if it is able and willing to do so.

37. On the other hand, it might be argued that it would be possible to secure that each person was taxed according to his ability to pay through an equilibrium of Central and Provincial taxation so arranged that while neither system tapped the ability to pay of all the inhabitants, the two combined might do so. Such a system, however, it might be argued, is wrong in theory, for it presupposes a static position and it would unduly hamper each authority in adjusting its taxation to its needs. If one authority happened to need more money and the other less and each adjusted its taxation accordingly, the whole system would be thrown out of gear.

38. It might also be urged in this connection that succession duties, which under the Devolution Rules have been assigned to Provinces, provide a means whereby the system of provincial taxation can be modified to reach the ability to pay of the inhabitants. Inasmuch as these duties fall on realised property and do not affect the man who spends a large portion of the income

that he earns, they are theoretically a less satisfactory method of reaching the ability to pay of the whole of the wealthier classes. They do, however, afford a valuable means of increasing to a legitimate extent the burden upon such classes, and if a developed system of succession duties were imposed in the provinces, the force of the arguments against the present distribution would be considerably weakened. It is contended, on the other hand, that partly owing to political difficulties and partly owing to the complexities of the Hindu law of inheritance and other legal difficulties, it would be very unsafe to rely on them. for some years at any rate, as a source of provincial revenue. At least three of the provincial governments seriously considered the possibility of the imposition of death duties, but apparently found the difficulties almost insurmountable. Indeed, the Taxation Committee has definitely recommended that the legislation connected with these duties should be Central.

39. The fourth criticism is that in accepting the scheme for a complete separation of the sources of revenue and recommending the total abolition of the provincial contributions, the Joint Select Committee ignored the importance of certain features which are peculiar to the Indian problem. The Indian provinces, as is well-known, have grown in a haphazard fashion. When a new tract of country was annexed or conquered by the British, it was added to one of the existing provinces or constituted into a separate province according to administrative convenience. They were therefore never at any time independent fiscal units, at any rate since 1833, and until the Reforms they were merely the agents of the Central Government and spent money allotted by the latter. Moreover, frequent changes have been made in the boundaries of provinces within the last thirty years (*e.g.*, United Provinces, the North-West Frontier Province, Bihar and Orissa, Berar, Assam). For these and other reasons connected with the circumstances of their growth, it is urged that they could not be expected to function as self-supporting fiscal units of administration.

They also came under British rule at different dates and in different stages of development. In view of the importance of the maintenance of uniform standards of administration in the different provinces, it is pointed out that, quite rightly, the allocation of revenues before the reforms was made with reference to the needs of the provinces and not with reference to the revenue collected within the province. The Meston Committee partially recognised the importance of this factor and in de-

termining the initial contributions they deliberately treated some of the provinces rather more generously than the others. They distinctly stated that the *standard contributions*, which were proposed with reference to the taxable capacity of the provinces and other circumstances, were the ideal which was to be reached after the provinces had had time to adjust their budgets to the new state of affairs. The rejection of this part of the scheme by the Joint Select Committee and the final extinction of the provincial contributions have, it is urged, restored the inequalities referred to by the Meston Committee.

40. The validity of the fifth criticism arising out of the failure of Devolution Rule 15 to operate as intended has been admitted by the Government of India on several occasions. The point will be dealt with in some detail in a later passage of this Memorandum which relates to suggestions for the division of the income-tax in any future scheme of allocation.

41. To meet the sixth criticism, for which also there was considerable justification, the Government of India have with the approval of the Secretary of State recently introduced a new scheme of famine insurance, under which the total annual provincial contributions to the Fund will be reduced from Rs. 175 lakhs to Rs. 42 lakhs. The nature of the changes introduced will be described in a separate memorandum.

42. The following three statements illustrate some of the points in the criticisms directed against the present scheme. It is hardly necessary to add that none of the criteria adopted below is by itself adequate for testing the equity of the settlements, but these statements collectively may serve to indicate the inequalities which, it is urged, have resulted from the present distribution of resources :—

(1) The statement below compares the standard revenue adopted in the permanent settlement of 1911 with the increased income that the provinces have obtained by (*a*) the normal growth of revenue under the divided heads between 1911 and 1920, and (*b*) the increased revenue presented to the provinces by the abolition of the system of divided heads and the final extinction of the provincial contributions. The growth of revenue since the Reforms has not been taken into consideration, because provincial governments have had independent powers of taxation since 1920 and the growth during this period is partly due to taxation levied by the provinces. The importance of this statement lies in the fact that the standard revenue in 1911 was

determined with reference to the actual needs of the provinces.

[In lakhs of rupees].

Province.	Standard revenue adopted in 1911.	Increased income resulting from the normal growth of revenue between 1911-20, the Meston Settlement and from the extinction of Provincial contributions.	Percentage increase.
Madras ..	625	830	133
Bombay ..	630	486	77
Bengal ..	563*	251	45
United Provinces.	559	619	111
Punjab ..	300	508	141
Burma ..	485	374	77
Bihar & Orissa	271*	113	42
Central Provinces.	245	131	53
Assam ..	123*	70	57

(2) The following statement shows the approximate provincial revenues per head of the population and per square mile in the year 1926-27 as they would have been if no contributions had been paid to the Central Government in that year :—

Province.	Per head of the population.	Per square mile.
	Rs.	Rs.
Madras	3·979	1,184
Bombay	6·956	1,089
Bengal	2·249	1,367
United Provinces	2·843	1,213
Punjab	5·663	1,173
Burma	8·356	472
Bihar and Orissa . ..	1 689	690
Central Provinces	3·804	530
Assam	3·399	488

(3) The statement given below shows the actual increase in the income of the different provinces between 1912-13 and the current year :—

[In lakhs of rupees.]

Province.	Average of 1912-13 and 1913-14.	Budget 1928-29.	Difference.	Percentage increase.
Madras	783	1697	914	117
Bombay ..	794	†1436	642	81
Bengal	669	1093	424	63
United Provinces ..	694	1247	553	80
Punjab	485	1273	788	162
Burma	585	‡1122	537	92
Bihar and Orissa ..	321	574	253	79
Central Provinces ..	316	554	238	75
Assam	170	278	108	63

*Figures of 1912-13 *minus* the special contributions of the Government of India in that year.

†Excludes interest received from the Local Bodies in Bombay, being merely a book adjustment.

‡Includes revenue from Shan States Federation for purposes of comparison.

The Financial position of the provinces.

43. The general nature of the criticisms made by provincial governments has been described. A brief account* of the actual operation of the Meston Settlement in each province will now be given. Attached to this Memorandum are a number of statements which exhibit the financial position of the provinces between the years 1921-22 and 1928-29.

44. *Madras.*—Madras had deficits for four years in succession after the War, which were mainly due to the necessity for increasing the pay of the subordinate staff required for purposes of administration. The accounts of the year 1921-22 showed a revenue deficit of Rs. 99 lakhs, and in spite of drastic reductions in expenditure and increases in the rates of stamp duties court fees and registration fees, which were expected to yield Rs. 77½ lakhs, the budget for 1922-23 anticipated a deficit of Rs. 42 lakhs. By the end of 1923-24, however, the financial position, considerably improved. The revenue showed signs of recovery and the policy of retrenchment was also pursued consistently. In spite of a provision of Rs. 57 lakhs for new schemes and grants to local authorities, the budget for this year showed only a deficit of Rs. 25 lakhs, which was turned into a surplus owing to an unexpected windfall and a saving of Rs. 59 lakhs in expenditure. In the following year, further retrenchments were made, which were expected to result in a saving of Rs. 18 lakhs during the year and Rs. 36 lakhs ultimately. The budget anticipated a surplus of Rs. 15 lakhs over the expenditure in spite of the inclusion of new items costing over Rs. 20 lakhs. In 1925-26 the contribution of the province to the Central Government was reduced by Rs. 126 lakhs, and this sum was partly utilized for repayment of loans borne upon the old provincial loans account which had hitherto been met by fresh borrowings. Since then, mainly owing to the remission of the provincial contributions, Madras has had big surpluses, the utilisation of which has been engaging the attention of the provincial government.

The grievance of this Government was that it was obliged to contribute a disproportionately large portion of its income towards Central expenditure. With the final remission of the provincial contribution, the province has been placed in an exceptionally favourable position.

45. *Bombay.*—This province had an opening balance of Rs. 306 lakhs on 1st April 1921, but the accounts for that year showed a revenue deficit of Rs. 191 lakhs and the budget estimates for 1922-23 anticipated a revenue deficit of Rs. 50 lakhs in spite of increases in the rates of stamp

*These accounts are largely based on the annual reports submitted by the Provinces.

duties and court fees, which were expected to yield an additional revenue of Rs. 60 lakhs in that year. The major portion of the deficit, however, was due to heavy interest charges on the debt incurred in connection with development operations in the city of Bombay. It was expected at the time that it would be possible to recoup these amounts from the sale of land reclaimed. This expectation, however, has not been realised and the financial difficulties of this province in the subsequent years are, to a considerable extent, due to the commitments on account of these schemes.

The budget of 1923-24 would have shown a small surplus, but for the interest charges of Rs. 63 lakhs on account of the Development Department. In the following year again, in spite of retrenchments in expenditure to the extent of Rs. 32 lakhs recurring, the budget anticipated a deficit. In 1925-26 the totalisator betting tax and in 1926-27 a tax on transfer of property in Bombay were introduced. The rates of court fees were also enhanced. But in spite of the additional taxation amounting in all to about Rs. 90 lakhs introduced since the Reforms and the drastic retrenchments made in expenditure, the province has had a series of deficits, which have reduced the opening balance of Rs. 306 lakhs in 1921 to Rs. 7 lakhs at the end of 1928-29 (budget).

Apart from the financial embarrassments caused by ventures such as the Bombay development scheme, these difficulties would seem to be due largely to the fact that Bombay is the most highly industrialised province in India and that it has a higher proportion of urban population than any other province. The standard of living is comparatively high in the industrial cities of the Presidency and, owing to the migratory character of the labour population, this has, it is stated, indirectly affected the standard in the villages, to which most of the villagers, who resort to industrial centres, retire after a certain period. The scales of salaries particularly in the subordinate services, are much higher than in the other provinces, partly, it is stated, on account of the cost of living and partly on account of the alternative avenues of employment provided by industrial concerns.

On the other hand, the provincial revenue per head of the population in this Presidency is higher than in most other provinces. Two factors have possibly contributed to this result :—

(a) The development of industries and the urbanisation of the province have resulted in a more rapid increase in the values of land than elsewhere, and consequently in land revenue.

(*b*) The consumption of liquor is always abnormally high in industrial areas and Bombay, as has already been noticed, derives a larger revenue from excise per head of the population than any other province in India.

The Meston Committee, it may be noted, pointed out that Bombay had reached a scale of expenditure far above the Indian average and that the pace of expansion of its revenues was also distinctly higher than in other provinces.

46. *Bengal.*—Bengal started with an opening balance of Rs. 272 lakhs in the beginning of 1921-22, most of which, however, was wiped out by the revenue deficit of Rs. 216 lakhs at the end of that year. In the following year, owing to its peculiar financial difficulties, its contribution to the Central Government was remitted after a detailed and careful examination of its financial position. Additional taxation in the shape of higher stamp duties and court fees and an entertainment tax, which was estimated to yield altogether Rs. 140 lakhs was also imposed. By this means and by retrenchment in expenditure, the province was able to maintain a small surplus until 1926-27 when for the first time for several years, the accounts showed a deficit of Rs. 21 lakhs. The revised estimates for 1927-28 and the budget estimates for 1928-29 also anticipate small deficits.

Judged by these figures, the financial difficulties of Bengal have not been as serious as those of Bombay, but it is stated that there has been very little development in the nation-building services entrusted to the Ministers since the Reforms, owing to the impossibility of providing additional resources. The difficulties of the province arise from the inelasticity of the two principal sources of provincial revenue, *viz.*, land revenue and excise. Owing to the Permanent Settlement and the temperate habits of the people and the movement in favour of prohibition throughout India, neither of these sources of revenue has shown itself capable of expansion comparable to that enjoyed by Bombay from the same sources. The situation, it is stated, so far as Bengal is concerned, is further aggravated by the fact that the administration of Calcutta, which is an all-India port and which contains practically all the big jute mills, absorbs a disproportionately large portion of provincial revenues. The cost of the Calcutta police in 1925-26 was more than Rs. 31 lakhs. The case of Bengal, in short, is that there is no margin for development. In fact, if the fall in the purchasing value of the rupee were taken into consideration, it might be argued that there has not been any appreciable increase

in the spending power of the province since 1913 (see statement in paragraph 42).

On the other hand, it might be argued that there has been very little development of local taxation in this province. The great controversy that arose in 1871 in Bengal regarding the legality and propriety of levying a cess for educational purposes on permanently settled land was finally settled by a formal pronouncement of the Secretary of State distinctly affirming the liability of such land to additional taxation in the shape of local cesses and rates. A local cess has ever since been in existence in Bengal but, although there is no legal impediment in the way of an increase in the rates of these cesses, there has been very little increase in the income of the rural boards, which has risen from Rs. 66.19 lakhs in 1918-19 to only Rs. 76.25 lakhs in 1925-26.

47. *The United Provinces.*—The annual accounts of this province show a succession of deficits since the introduction of the Reforms up to the end of 1925-26 amounting in all to over Rs. 3 crores, which were met partly from the opening balance of Rs. 89 lakhs at the beginning of 1921-22 and partly by the appropriation of a considerable portion of a loan which the provincial government had raised in the open market for development purposes. Except for an increase of irrigation rates and court fees, there has been very little additional taxation. It may be noted that this Government had to be warned by the Government of India that no loans would be sanctioned, whether they were to be raised in the open market or obtained from the Central Government, if the proceeds were likely to be applied in practice to the financing of revenue deficits.

The general financial position was a source of considerable anxiety until the year 1925-26 when, owing mainly to the remission of Rs. 56 lakhs of its contribution to the Central Government, financial equilibrium was expected to be restored. The actuals of the year, however, showed a deficit of Rs. 31 lakhs. With the gradual reduction and final cessation of its contribution, the financial position has improved very considerably and the revised estimates for 1927-28 show a surplus of Rs. 152 lakhs. The following remarks of the Finance Member of the Province in his budget speech in 1927 summarise the present financial position of the Province :—

> "How much yet remains to be done I recognise as clearly and as readily as any one. But there is reason to hope that in the matter of finance, we are at length turning the corner. The remission of our contribution for which the budget of the Central Government

provides will add materially to our resources. Further our revenues will before long steadily increase..... Our revenues, however they may expand, will never be in excess of our needs. But in the coming years they will, I believe, be more adequate to our requirements than they have been in the period that has elapsed since the Reforms."

Since then the province has received the benefit of the final remission of the last instalment of the provincial contributions.

48. *The Punjab.*—The revenue of this province has increased from Rs. 710 lakhs in 1921-22 to Rs. 12,73 lakhs in 1928-29 (budget) and its finances seem to be in a very flourishing condition. But it did not escape from the consequences of the rise in prices, the depression in trade and other factors which contributed to the financial embarrassments of the other provinces and of the Government of India in the first few years following the introduction of the Reforms. The revised estimates for 1921-22 and the budget estimates for 1922-23 disclosed deficits amounting to Rs. 149 lakhs and Rs. 130 lakhs respectively. Additional taxation, which mainly took the shape of increased registration fees, mutation fees, court fees and stamp duties, was imposed in 1923 and a persistent effort was also made to reduce the expenditure. The deficits in these two years were, however, due in part to certain specific abnormal causes such as a particularly bad monsoon in 1921-22, and with the normal increase in revenue financial equilibrium was restored in 1923-24, since when the province has been free from serious financial difficulties arising from failure of resources. The revenue surpluses in the years 1923-24 to 1925-26 amounted in all to over Rs. 4½ crores. Apart from the normal growth of revenue, these were partly due to the sale proceeds of land and to the increase in the water rates on the canals in 1924. With the remission of provincial contributions, the province was actually able to reduce its taxation in 1925-26 and 1926-27 and has been able to finance a large portion of its capital expenditure on productive schemes such as irrigation works, from revenue. In 1927-28 (revised estimates), Rs. 125 lakhs were spent from revenue on capital expenditure, while in the budget for the current year provision has been made for an expenditure of Rs. 134 lakhs on irrigation and civil works to be met from revenue. It is also understood that the Government have been considering the question of further remission of taxation, if this should be found feasible after the requirements of the province are met.

49. *Burma.*—The statement annexed to this Memorandum relating to the finances of Burma since 1921-22 does not fully reveal the actual financial position. A peculiar feature of the finances of this province was the very large receipts realised before the Reforms from the system of rice control, which have to a very great extent been utilised subsequently for financing capital expenditure. While the figures of revenue since the Reforms have also been swelled to a small extent by such abnormal receipts, the figures of expenditure include a very large amount of capital expenditure incurred from the accumulated rice control profits. The amounts of non-recurring capital expenditure proposed to be met from these balances in the budgets of 1923 to 1927 are shown below :—

(In lakhs of rupees.)

1923-24.	1924-25.	1925-26.	1926-27.
191	118	88	203

In fact, the province was able to meet all its capital expenditure until 1927-28 without borrowing and the apparent revenue deficits shown in the accounts have been met from the huge opening balance of Rs. 572 lakhs with which it started in 1921-22. It will be observed from the statement that this province raised no loans in the market and owed no money to the Government of India until 1927-28. Its opening balance, however, has been reduced from Rs. 572 in 1921-22 to Rs. 9 lakhs in 1928-29 (budget estimates).

With the exhaustion of the amounts to the credit of the rice control account, the question of balancing the provincial budget will become a matter requiring serious consideration. The financial position of this province is in many ways somewhat peculiar. It was the last province to come under British rule and it is still very largely undeveloped. Its system of taxation continues to be of a very primitive character and the revenue from land is small. Unlike the rest of India, it had no regular system of land taxation before British rule. Upper Burma relied and still relies very largely on the *thathameda*, which is a tax apportioned among the villages and assessed roughly with regard to the circumstances of each family in the village. Though theoretically it is not a poll tax, it operates as one. In Lower Burma, the principal tax has been the capitation tax, which is now levied at a flat rate on all males between the ages of 18 and 60 years. Since 1893 a land tax on private lands has been partially substituted for the *thathameda* but the land revenue system is still undeveloped. Except in some of the bigger towns, there is no system of local taxation independent of the provincial administration.

There has been for several years a very strong popular demand in Burma for the abolition of the two primitive taxes, the *thathameda* and the capitation tax, and on the advice of a committee recently appointed by the local Government, it has been decided to earmark the proceeds of these two taxes for local purposes. They are therefore in theory at any rate no longer available for provincial purposes.

50. *Bihar and Orissa.*—The financial difficulties of Bihar and Orissa are very similar to those of Bengal. Its revenues are very inelastic, on account of the permanent settlement and its solvency during recent years has depended on the vagaries of the excise revenue. Its revenue per head of the population is the lowest in the whole of India and the province is still very largely undeveloped. In view of its peculiar position, the Meston Committee recommended that no share of the "initial contributions" towards Central expenditure should be demanded from it.

By additional taxation and by a conservative policy as regards development, it was able to avoid a revenue deficit until 1926-27, the accounts for which year show for the first time since 1921-22 an excess of expenditure over revenue of Rs. 31 lakhs. The revised estimates for 1927-28 and the budget estimates for 1928-29 show deficits of Rs. 29 lakhs and 14 lakhs respectively. The financial difficulties of the province will begin when the opening balance, which amounted to Rs. 101 lakhs in the beginning of 1921-22, has been exhausted and the demands for the development of the nation-building services become more insistent.

51. *Central Provinces.*—In the first year after the introduction of the Reforms, the accounts of this province showed a deficit, which was met from the opening balance of Rs. 51 lakhs. As a result of the additional taxation imposed in 1923 and the policy of retrenchment, there was a surplus in the following four years. There was, however, a deficit of Rs. 67 lakhs in the year 1926-27, which was mainly due to the fact that the Act of 1923 authorising the increases in the rates of stamp duties and court fees for three years expired in this year. With the remission of the provincial contributions, financial equilibrium has again been restored and the financial position of the province is stated to be satisfactory.

52. *Assam.*—Assam had small revenue deficits during the first two years after the introduction of the Reforms, but owing largely to an improvement in its revenue position, the province has not been faced with any serious financial difficulties since 1923-24. With the remission of the contri-

bution of Rs. 15 lakhs, its financial position has been further strengthened. It has also, owing to a change in the income-tax law, got larger amounts under Devolution Rule 15 than any other Province except Burma during recent years.

53. It would seem from the survey of the finances of the various Provinces since the introduction of the Reforms that the criticism regarding the inequalities arising from the scheme of allocation of revenues is not without justification. It might be argued that the remedy for these inequalities would be a fresh re-distribution of resources. On the other hand, there is not a clean slate to write upon and practical considerations impose limits on the scope for a revision of the settlement. Rightly or wrongly, certain revenues have been allocated to Provincial Governments, who have adjusted their standards of expenditure accordingly. It would be impracticable to demand that schools and hospitals should be closed in one Province in order to provide additional resources for other Provinces which are less developed and which in the earlier settlements received resources which they found inadequate. From this it would follow that no alteration in the distribution of the sources of revenue would be possible except in respect of such taxes included in the Scheduled Taxes Rules as have not already been exploited by Provincial Governments unless—

(*a*) other sources of revenue are offered by the Central Government as compensation, or

(*b*) definite fixed or variable assignments are made.

In other words, the inequalities arising from the present settlement can in practice only be removed by the sacrifice of Central revenues, either existing or potential. So far this has been found to be impracticable. The abolition of the Provincial contributions in 1928-29 has for the time being left practically no margin in the Central budget. It would, in fact, not have been possible to carry out in the current year the partial revision of the Meston Settlement referred to in paragraph 26 even if the Provinces had agreed to it, and in contemplating the possibility of an inroad upon Central revenues it is necessary to bear in mind the Central liabilities arising out of the very responsible functions, such as defence, assigned to the Central Government under the constitution.

Possible Lines of Development.

54. It is now proposed to discuss various remedies that have been suggested for removing the inequalities arising from the present distribution of resources. These are :—

(1) The introduction of a system of grants-in-aid for specific ser-

vices, as distinguished from contributions for general purposes referred to in (5).

(2) A partial reversion to the system of divided heads.

(3) Empowering Provincial Governments to levy a surcharge on some of the Central taxes.

(4) A re-distribution of the sources of revenue now allocated to the Central and Provincial Governments.

(5) The grant of fixed or variable contributions from the Central Government to the Provincial Governments or *vice versa*, if an equitable distribution cannot be effected by one or more of the methods indicated above.

Grants-in-Aid.

Possibilities of a system of grants-in-aid.

55. It has been explained in a separate Memorandum that under the existing constitution of India it is not permissible to make assignments or grants from Central Revenues to Provincial Governments for expenditure on a Provincial subject. The origin of this arrangement may be traced to the conception in para. 201 of the Report on Indian Constitutional Reforms, that "if provincial autonomy is to mean anything real, clearly the provinces must not be dependent on the Central Government for the means of provincial development." The soundness of this conception, as a general proposition, is hardly open to doubt, as Professor Seligman has observed* : "To have the federal government depend entirely upon largesses from the states is to render it more or less impotent, and certainly to make it subordinate to the states. * * * * On the other hand, to make the separate states depend financially upon the federal government is to weight the balance in the opposite direction and is not, in the long run, desirable in the interests of a complete equilibrium."

56. At the same time, it is possible to argue with some force that it is neither necessary nor desirable to have any hard and fast rule on the subject in the Indian constitution. No such rule exists in the constitutions of the Dominions or other federal states ; and as it has been mentioned in a separate Memorandum that grants-in-aid from federal revenues to the States have been given in Canada for the purpose of constructing and improving the highways, and of developing agricultural and technical education, and in Australia for the provision of hospital treatment for persons suffering from venereal diseases. Further, as stated in that Memorandum, the existence of the rule in

*Seligman : Essays in Taxation, pages 666-667.

the Indian constitution has led to administrative difficulties. There are, however, more general considerations. Thus it will be for consideration whether the Central Government should not be competent on suitable occasions to utilize any surplus revenues at its disposal not for the remission of Central taxation but for the allotment of money as grants-in-aid to the provinces for a series of years so as to enable them to make more rapid progress with measures of national development or measures necessitated by India's international commitments than is possible with the unaided resources of particlar provinces. Similarly it may be found, when spheres of taxation have been allocated, that in certain circumstances it would be suitable that the Central Government should raise further taxation on a uniform all-India basis and make the proceeds available to the provinces for national development in a particular direction, *e.g.*, construction of roads. It is, therefore, a matter for careful consideration whether the rigid rule in the Indian constitution should not be abrogated, and the Central Government given a free hand to make grants to Provincial Governments for specified purposes, subject to the vote of the Central Legislature.

57. In connection with these grants-in-aid from Central Revenues, there is a further question which will require consideration, *viz.*, the degree of control which the Central Government should exercise in regard to services in the provinces for which a grant-in-aid is given from Central Revenues. In England, grants are made out of sums voted by Parliament to local authorities for the purpose of meeting a portion of the expenditure on services of national importance, like education, police, etc., and in connection with these grants a high degree of central control is imposed on the local authorities. In the words of a well-known authority* on local self-government in England "the National Government in the course of three-quarters of a century from 1832 successively 'bought' the rights of inspection, audit, supervision, initiative, criticism and control, in respect of one local service after another, and of one kind of local governing body after another, by the grant of annual subventions from the national Exchequer in aid of the local finances; and therefore, in relief of the local ratepayer." In India a somewhat similar control is exercised in connection with grants made to local authorities by the Provincial Governments or by the Central Government in areas directly administered by it. The question of the degree of control that should be exercised over provincial administrations consequent on the acceptance by the provinces of grants-in-aid

*Sydney Webb's Grants-in-Aid, page 6.

from Central revenues requires careful consideration. It would probably be not unreasonable for the Central Government to demand in connection with these grants the right to co-ordinate the activities in the various provinces with a limited amount of control which may be requisite to secure a uniformity of standards and a synchronisation of the pace of progress in the various provinces. It is a much more difficult question, however, whether in the case of provincial services, a portion of the expenditure on which may be met from grants from Central Revenues, the Central Government should have the right to impose a degree of control similar to that which has already been described as prevailing in England, and in India also in respect of the activities of local authorities. Under the Canada Highways Act of 1919 (9-10 George V Chapter 54) the payment of grants to the provinces is subject to the following conditions :

(*a*) Any highway for which aid is granted shall be constructed or improved, as the case may be, in accordance with the terms of an agreement to be made by the Minister (of the Federal Government) with the Government of the province. Such agreement must be approved by the Governor in Council and shall contain such provisions, as to location, cost, description, specifications, time and method of construction, supervision and other necessary particulars as are essential to protect the public interest. Except for reasons set forth in such Order in Council and except with the consent of both Governments, all expenditure under the Act shall be by tender and contract.

(*b*) The aid to be given in any case shall be forty per cent. of the amount which in the opinion of the Minister is the actual, necessary and reasonable cost of the construction or improvement of such highway as the case may be.

The Canadian Technical Education Act of 1919 (9-10 George V Chapter 73) similarly prescribes the terms and conditions upon which payments of grants from Federal Revenues for technical education are to be made to the provinces. These precedents suggest that the question of control conditioning grants-in-aid must be determined not only with regard to the constitutional position of the Central and Provincial executive but also with regard to the discretion of the Central Legislature to attach conditions to grants-in-aid requiring its authorisation.

System of Divided Heads.

A partial reversion to the system of divided heads.

58. Opinion in India, official as well as non-official, has for many years advocated the complete separation of the sources of revenue of the Central Government and the Provincial Governments as an ideal towards which the financial policy of the Government of India should tend, and any suggestion for even a partial reversion to the system of divided heads might be regarded as economic heresy and would probably be received with considerable distrust by the Provincial Governments. It is therefore desirable to analyse the reasons which necessitated the meticulous control associated with that system and to discover whether administrative control is an inevitable result of any system of divided heads. The circumstances which led to this control under the pre-Reform settlements are stated as follows in para. 109 of the Report on Indian Constitutional Reforms:—

> "Because provincial settlements have been based, not on provincial revenues but on provincial needs, a central control over provincial expenditure is not merely justifiable but inevitable. The Government of India could not allow a province to go bankrupt. But if the Government of India were responsible for provincial solvency, they must be in a position to control provincial expenditure; indeed, in view of their own competing needs, they could hardly avoid feeling a direct interest in keeping down charges. Again, as regards revenues, so long as the Government of India take a share in the proceeds, they have a strong motive for interfering in details of administration. Their interest in land revenue, for example, inevitably leads them to a close supervision over revenue settlements; and the control tends to become tighter in cases where expansion and development, as in the case of irrigation, depend on capital outlay."

It was in order to avoid this control and interference by the Government of India in Provincial matters that the authors of the Report aimed at finding some means of entirely separating the resources of the Central and Provincial Governments. They were of opinion that the arrangements which had on the whole worked successfully between two official governments would be quite impossible between a popular and an official government.*

*Para 200 of Report.

59. There are, however, several methods by which the proceeds of a tax may be divided between the Central Government and a Provincial Government. The division may be effected by—

(*a*) a division of the sphere within the tax itself, or

(*b*) the assignment to one or the other of the authorities of a basic rate, the balance to go to the other authority, or

(*c*) a division in accordance with some arbitrary fraction.

It is only to the third method that the arguments stated in the quotation above have any application. For instance, they could not be urged against a scheme for the division of the proceeds of a tax on tobacco, under which the excise duty would be credited to the Central Government, while the Provinces would be allowed to levy fixed license fees on shops for the sale of tobacco. Nor would they apply to a method for the division of income-tax under which the taxation on corporations is assigned to one and that on individuals to another, or to a scheme for the division of the proceeds of a Central tax collected directly by a Central Department.

60. The possibility of dividing the sources of revenue now classified as Central or Provincial may now be considered It may be premised that division will not be appropriate in the case of all heads, and that it will be convenient for certain heads to remain wholly Provincial or wholly Central.

61. *Land Revenue.*—Land revenue appears to be a source of revenue which should appropriately belong to the Provincial Government. Not only does its intimate connection with all the details of Provincial administration render it pre-eminently a Provincial subject, but on theoretical grounds also it is clearly appropriate for Provincial or local taxation. Indeed, in most of the countries of Europe, the land tax is almost entirely appropriated for local purposes.

62. *Court Fees.*—Court fees may be regarded either as a payment for services rendered or, if they appreciably exceed the cost of the courts, as a tax. In either case, being connected closely with Provincial subjects and falling almost entirely on the inhabitants of the Province, they have been held to be clearly suitable for assignment to the Province.

63. *Non-judicial Stamps.*—Stamp duties can be divided into two appropriate classes :—

(1) Those which relate to commercial and quasi-commercial transactions.

(2) Those which relate to other transactions, particularly concerning land.

Under the present system, certain stamp duties which it is considered important to keep uniform on account of their commercial importance are reserved, so far as the rate is concerned, for Imperial legislation. All other stamp duties can be altered by the Provinces and the revenue from the reserved duties also goes to the Provinces or, speaking more accurately, to the authority which happens to sell the stamp which is used. So far as the commercial transactions are concerned, it is obviously important that the rate should be uniform throughout India. Moreover, such important problems as the extension and improvement of banking and money market facilities with which the Central Government have to deal are closely bound up with questions of stamp duty relating to commercial transactions. Uniformity of other stamp duties is not, however, essential and there does not seem to be any serious objection to a variety of rates.

The authors of the Report on Indian Constitutional Reforms had intended that the revenue from general stamps should be allocated to the Central Government, but it was diverted to the Provincial exchequer by the Meston Committee because they could find no other means of securing a complete separation of the sources of revenues between the Provincial and Central Governments which would give adequate revenue to certain Provinces. The Taxation Committee suggested the re-transfer of non-judicial stamps to the Central Government but, as has already been stated, owing to strong objections raised by some of the Provincial Governments, the Government of India proposed that commercial and quasi-commercial stamps should be assigned to the Central Government while all other stamps should continue to be Provincial. The question was referred to a sub-committee of the Conference of Financial Representatives held in November 1926 and a list of instruments, the stamp duty on which the sub-committee recommended should be credited to the Central Revenues is given in Appendix II.

64. *Customs duties—Export duties.*—Export duties differ from import duties in the fact that their incidence is not always on persons subject to the jurisdiction of the State. The accepted theory is that when an export duty is imposed on a real monopoly, the tax falls upon the foreign consumer and to the extent to which the article is not a monopoly, the tax tends to shift from the foreign consumer to the home producer. Export duties are generally recognised as a pernicious form of

taxation. In fact, the constitution of the United States of America prohibits absolutely the imposition of such duties. Their injurious effect is recognized in the Resolution of the International Economic Conference which severely condemns this form of taxation.

The principal argument that has been urged in support of the claim by some Provinces for a share of the proceeds of these duties is based on the assumption that the articles on which the duty is levied are not a complete Indian monopoly. The principal export duties levied in India are on jute and rice. In the case of both these articles, however, the incidence of the tax can be fairly definitely localised, for Bengal practically monopolises the export of jute while Burma exports more than 90 per cent. of the total quantity of rice sent out from India. It is also possible to argue that to the extent that the tax falls on the producer, the margin of taxation on land for State or local purposes is reduced. The objections to the division of the proceeds of these duties are stated below :—

(1) In the first place, the primary justification for the levy of export duties, especially on jute and rice, lies in the fact that they are practically Indian monopolies. Jute is almost an absolute monopoly, while, in the case of rice, the monopoly is shared by Indo-China and Siam, which also levy similar duties. It has been argued that the taxes in both cases fall on the foreign consumer and there is therefore, no theoretical justification for assigning a share of the proceeds of the duty to any individual Province.

(2) There are also practical objections. These export duties may not be a permanent feature of the Indian financial system. If a substitute were found for jute, it would be necessary to reduce or abolish the tax entirely, and if a Provincial Government were interested in the duty, it might be more difficult to make any change to protect the interests of the trade. The fate of the saltpetre industry in India emphasises this point. The export duty levied on saltpetre in 1860 stimulated the manufacture of artificial saltpetre to such an extent that within a period of six years the export was reduced to less than one-third. As stated in the quotation from Sir John Strachey given in the Report of the Fiscal Commission, "export duties enjoy the credit of having

ruined the Indian trade in saltpetre. They were taken off when it was too late to repair the mischief."*

65. *Import duties.*—The general objection to the appointment of customs duties does not apply to articles such as liquor which are ordinarily transported in bond. The question of sharing the proceeds of customs duties therefore arises only in the case of wines and liquor. From the administrative point of view, it might also be considered desirable that the position as regards the sphere in respect of foreign liquor should be clearly defined in order to avoid a conflict of interests between the Central and Provincial Governments in India. This conflict arises in three ways :—

(1) Provincial Governments can now tap what is really a Central source of revenue by a levy in the guise of vend fees or transport fees what is really an addition to the duty on this class of liquors.

(2) Provincial Governments may, in pursuance of their policy of prohibition, restrict or prohibit the sale of foreign liquor.

(3) Provincial Governments may encourage the sale of country-made foreign liquor (the excise duty on which, under the present system, is credited to Provincial revenues) to the detriment of the sales of imported liquor and of Central revenues.

A division of the proceeds of the customs duty on foreign liquor on the following lines might be viewed as unobjectionable theoretically and would also avoid the present conflict of interests, provided certain restrictions are imposed in order to enable the Central Government to fulfil their obligations under international treaties :—

(*a*) Customs duties on imported liquors might be fixed on an *ad valorem* or specific basis and foreign liquor might be subjected to a duty at the general rate of 15 per cent. or it might be treated as a luxury article and subjected to a duty of 30 per cent. The present rates amount to 75 to 100 per cent. *ad valorem.* The liquor might be transported in bond and Provincial Governments might be allowed to levy excise duties at any rate they considered necessary.

*Report of the Indian Fiscal Commission, page 105

(b) An alternative to this would be to abolish customs duties on imported liquor altogether and to allow Provincial Governments to levy excise duties as they thought fit on foreign liquor consumed in their territories. The proposal has been described in another memorandum, but it may be mentioned here that the complete abolition of customs duties would seem to be a serious step.

The following statement shows the consumption of imported spirits in the different Provinces in the year 1925-26 :—

	Thousands of proof gallons.
Madras	103
Bombay and Sind	269
Bengal	223
Bihar and Orissa	16
United Provinces	70
Punjab	53
Central Provinces	15
Assam	13
Territories under the Government of India	45

It will be observed that a distribution of the customs revenue on the lines indicated above would largely benefit Bombay and Bengal, which are the Provinces that have suffered most by the defective operation of Devolution Rule 15.

66. *Salt.*—In the case of the tax on salt, it is not easy to trace consumption. Salt being a necessity of life, it might be argued that a distribution of this duty on a population basis would not be open to any theoretical objection. There are also possible political advantages in making this a divided head. As a matter of fact, however, owing to differences in diet, the average consumption per head of the population varies considerably in the different provinces. Moreover, it is practically the only big reserve which the Government of India have in the case of an emergency such as war.

67. *Excises.*—Where the locality of consumption cannot be traced, it seems clear that an excise duty must be Central. In the case of the excise duty on liquors, duty usually follows consumption and so long as this principle is observed, there is no theoretical or practical objection to the allocation of this source of revenue to the Provinces.

The only other excise duty of importance that is now levied is that on petroleum and kerosene oil. The tax is levied at the refinery and though at the time of levy the destination of a particular consignment

may be known, it cannot be guaranteed that it will be consumed in a particular area. The fact that the transport and storage of petroleum is under license and that distribution is in the hands of one or two companies may, however, enable consumption to be traced adequately. In that case it would be feasible to divide this excise among the Provinces, if necessity for such a step should arise.

68. *Income-tax.*—The possible methods of dividing the income-tax, which has been the subject of controversy since the Reforms, will now be dealt with. The problem has been examined very exhaustively by the Taxation Enquiry Committee in paragraphs 528 to 538 of their report. The main reason why a division of the income-tax between the Central Government and the Provinces is desirable has been indicated in an earlier portion of the Memorandum. It is, briefly, that the taxation systems of the Provinces must be theoretically unsound so long as they do not embrace some method of levying progressive taxation upon ability to pay as represented by commercial and industrial interests. As has been observed in an earlier portion of the Memorandum, a division of the proceeds of the income-tax is already in force under Devolution Rule 15. In the form in which it now exists it provides that the Provincial Government shall receive three pies in each rupee on that portion of the assessed income in a Province which is in excess of the assessed income of the year 1920-21. The rule, however, has failed to give the commercial and industrial Provinces a share in the income-tax, since Bombay has received nothing since 1922-23 and Bengal since 1921-22, while Burma and Assam have received comparatively large assignments not from any marked expansion of non-agricultural income in the Province but owing to certain fortuitous circumstances. The following statement shows the actual amounts received by the Provinces since the Rule was introduced:—

Amounts realised by the Provinces under Devolution Rule 15.

(Figures in lakhs of rupees and two decimals).

—	1921-22.	1922-23.	1923-24.	1924-25.	1925-26.	1926-27.	1927-28 Revised.	1928-29. Budget.
Madras	4·08	..	10·82 (5·66)	1·57	4·27	4·64	5·20	6·50
Bombay	14·72	3·00	.. (13·50)	..	..	..	..	—
Bengal	0·95	..	..	..	..	..	..	—
United Provinces ..	3·20	0·33	..	..	0·03	..	..	..
Punjab	0·30	5·69	4·24 (0·06)	1·90	3·82	4·02	3·50	4·00
Burma	3·85	.. (1·11)	0·38 (—0·08)	5·90	8·92	14·32	15·00	14·00
Bihar and Orissa ..	0·58	2·87	2·55	2·55	2·41	3·25	3·60	3·50
Central Provinces ..	0·90	1·49 (0·39)	3·42	2·30	1·36	2·18	1·60	2·00
Assam	0·02	1·15	4·16	5·54	5·29	4·92	6·00	6·00
Total ..	28·60	14·53 (1·50)	25·57 (19·14)	19·76	26·10	33·33	34·90	36·00
		16·03	44·71					

N. B.—Figures in brackets indicate adjustments on account of previous years.

69. Apart from the fact that this plan of division has been a failure in practice, there exist reasons which render it unsuitable as a permanent method of dividing the income-tax with the Provinces. In the first place, its dependence on a datum line must necessarily involve arbitrary results. A Province which failed to assess its income-tax properly up to 1920-21 stands to gain out of the arrangement, while a Province which collected its income-tax efficiently stands to lose. Moreover, the income-tax in the commercial Provinces depends largely on the main industries and the periods of prosperity and depression in each of these do not necessarily synchronise. Another objection to the principle of the Rule is that, except in the case of businesses transferred for assessment from one Province to another, it takes no account of the claims of residents and enables the Province of origin to appropriate a share of the tax which is really paid by inhabitants of other Provinces. This objection, however, could be surmounted if proper arrangements could be made for the allocation of the revenue to the Province of origin. In fact, such arrangements are in force between the Government of Bengal and the Governments of Assam and Bihar and Orissa regarding the apportionment of the income-tax collected in Calcutta on the profits of tea and mining companies. The real defect of the Rule is that it does not enable a Province to reach the capacity of the income-tax paying classes as a whole. The share which the Province receives is merely a proportion of the income which exceeds that of the datum line and it is in no sense a share in the taxation of the income whose equivalent happened to be assessed to income-tax in the datum line year. The Taxation Enquiry Committee, therefore, condemned the system of distribution laid down in Devolution Rule 15 as fundamentally unsound.

70. Other possible ways of dividing the income-tax have been discussed in paragraph 530 of the Taxation Enquiry Committee's report. They are as follows :—

(1) The Provinces might be empowered to levy and administer an income-tax separate and distinct from that levied by the Government of India.

(2) The income-tax might continue to be levied by the Government of India, which might at the same time levy *centimes additionnels* for the benefit of the Provinces.

(3) The income-tax might continue to be levied by the Government of India, but a definite share of the yield might be allocated to the various Provinces on principles to be determined.

71. The principal objection to the first method, which is contemplated in various federal constitutions such as Australia,

Canada and the United States, is that the existence of two independent taxing authorities operating within the same sphere has given rise to serious difficulties and has been the cause of considerable irritation to the tax-payers. The system involves the submission of separate returns to two different authorities and the understanding of the provisions of two different taxing schemes. On the other hand, it might be argued that in several Provinces in India local authorities are already permitted to levy taxes directly assessed on income. Moreover, the exemption limit for the Central income-tax is regarded by many authorities as too high for Indian conditions and this might be urged as an argument for permitting Provincial Governments to levy an income-tax (not necessarily on the same basis as the Central income-tax) on the personal incomes of assessees resident within the Province. If they were permitted to do so, it would be necessary to impose certain conditions on the levy of the tax in order to prevent any encroachment by the Provinces on the fiscal sphere of the Central Government.

It may, however, be mentioned that quite recently Australia has discarded the first method in favour of the third (*vide* Appendix I); and that in Canada the Provinces in actual practice apparently derive their income-tax revenue from some form of corporation tax.

72. The second method, *viz.*, the levy of *centimes additionnels,* obtains as between the State and local taxation in France, Belgium and various other European States. The merits of the system and the reasons why it was rejected by the Taxation Enquiry Committee will be discussed in a subsequent paragraph.

73. The third method, in the opinion of the Taxation Committee, provides the most appropriate solution, since it involves no additional trouble either to the assessing authority or to the tax-payer and it permits of variations in the respective shares of the Central and Provincial Governments without any dislocation of the machinery of assessment and collection. The manner in which an allocation between the several Provinces of the total share allotted to them might be made is explained in detail in the following extract from the Committee's report :—

> "The Indian Income-tax and super-tax (excluding the super-tax on companies) is, like the British income-tax and super-tax, charged on a double basis. It is charged on all income received in British India from whatever source it may be derived, and it is charged on all income arising or accruing in British India, whatever may be the destination.

"In India, as in the United Kingdom, a large proportion of the yield of the income-tax is realised by the method known as "collection at the source". Under this system, the income-tax in respect of certain species of profits and interest is collected at the point where such profits or interest emerge. For instance, a limited company is required to pay income-tax at the maximum rate on the whole of the profits it makes without regard to their ultimate destination, and the burden of the tax is passed on to the shareholder in the shape of a reduced dividend. Similarly, the payer of interest on securities is required to deduct and pay over to the Revenue income-tax at the maximum rate on such interest. A similar provision exists in India with regard to salaries, subject to the un-important difference that the rate at which tax is deducted is that appropriate to the estimated total income of the recipient.

"Where tax has been charged at the source at the maximum rate and the total income of the recipient is such as to entitle him to a lower rate, provision is made for a refund based on the difference between the two rates. Accordingly, all profits from trade, etc., are ultimately taken as part of, and at the rate appropriate to, the total income of the individual to whom they belong. The sole exception to this rule is in the case of such portion of the profits of a limited company as are not distributed, but are placed to reserve. Here there is no single person to whom such profits can be said to belong, and they accordingly remain burdened with the tax at the maximum rate charged on the general profits of the company.

"It follows from what has been stated above that, in a number of cases, tax will be charged in a province in which a company carries on its business, but actually be borne by a person resident in some other province, and the question then arises in what proportion the income-tax is to be allotted as between the province in which the income arises, and in which the

tax is collected in the first instance, and the province in which the recipient of the income who ultimately bears the burden of the tax resides.

"The problem is not dissimilar in its main aspects from that involved in devising means for the avoidance of double income-tax as between two sovereign States. Both problems arise from the same cause, *viz.*, the existence of a double basis of liability, residence and origin, and if the relative weight to be attached to these two factors could be agreed upon, a theoretical solution of both problems would be easy.

"The problem has attracted considerable attention lately in Europe and in the United States, and in 1921 the Financial Committee of the League of Nations appointed a panel consisting of Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp to consider and report upon the matter.

"Their method of attacking the problem was to ascertain, as regards each category of wealth, where the economic allegiance lay in a preponderating degree, and they reached the following conclusions :—

Category of wealth.	Preponderant element.	
	Origin.	Domicile.
I.—Land	x	..
II. (*a*) Mines, oil-wells, etc.	x	..
II. (*b*) Commercial establishments ..	x	..
III. (*a*) Agricultural implements, machinery, flocks and herds.	x	..
III. (*b*) Money, jewellery, furniture, etc.	..	x
IV. Vessels..	Ax	..
Va. Mortgages	Bx	Cx
Vb. Corporate shares	x	
Vc. Corporate bonds	x	
Vd. Public securities	x	
Ve. General credits	x	
VI. Professional earnings	x	

(A) Country in which registered.

(B) Where the taxation of property is in question.

(C) Where the taxation of income is in question.

"They made no attempt to make an exact apportionment of the economic allegiance as regards each category of wealth and their views on this point are expressed in the following terms: "To allocate the exact proportion of economic allegiance to origin or domicile in each particular category is well-nigh impossible. Such an attempt would savour too much of the arbitrary."

"In fact, owing to the practical difficulty involved in the distribution of the income-tax between the country of origin and the country of domicile, the four economists came to the conclusion that "on the subject of income-taxation in its developed form, the reciprocal exemption of the non-resident is the most desirable practical method of avoiding the evils of double taxation and should be adopted wherever countries feel in a position to do so."

74. The Committee made several attempts to devise a scheme based on the classification referred to above, but they found it impossible to apply these principles to the peculiar conditions of India and they finally came to the conclusion that the only possible method was to base the distribution primarily on the principle of domicile, which also underlies the final conclusion of the four economists. The Committee's recommendations briefly were—

(*a*) The Provinces should be given the proceeds of a basic rate on personal incomes graduated proportionately to the general rate. For this purpose the basis of calculation would be the personal returns submitted under section 22 (2) of the Indian Income-tax Act, which provides for a statement of the income derived by the assessee from all sources, including dividends from companies wherever situated.

(*b*) In partial recognition of the principle of origin, each Province should be given a small portion of the receipts of the corporation profits tax.

75. Under the scheme proposed by the Committee, the Government of India would get—

(*a*) the whole of the collections on incomes that do not appertain

to residents in particular Provinces, such as the tax on undistributed dividends of companies,

(*b*) the tax on incomes of persons resident abroad or resident in places outside the boundaries of the Provinces, and

(*c*) the whole of the super-tax.

76. The object which the Committee had in view in suggesting the assignment of the proceeds of a graduated rate on personal incomes was to give each Province an amount varying with the taxable capacity of the inhabitants of that Province. The Taxation Committee's scheme seems to be theoretically sound, but a graduated basic rate would be inconvenient in practice, especially if the Government of India decided to adopt some other system of graduation. Nor would it be worth while, either from the Provincial or Imperial point of view, to graduate the rate with reference to taxable capacity so long as the Provincial Governments were not given the power to alter the rates. It would seem that a flat rate on the total assessable personal incomes would be simpler and more convenient, since the Provincial share under this formula would be quite independent of the system of graduation adopted by the Government of India. This modification was proposed by the Government of India in their letter to all the Provincial Governments on the recommendations of the Taxation Enquiry Committee. The question was also discussed at the Conferences of Financial Representatives in 1926 and 1927 and most of the Provincial Governments accepted the modified proposal. But it has not been carried into effect since the Provincial Governments could not agree upon the modification of the Meston Settlement of which this proposal was part and the Government of India themselves have no cause to introduce it as an independent measure.

77. *Super-tax on Companies* (*Corporation Profits tax*).—The second proposal of the Taxation Committee that in partial recognition of the principle of origin a small portion of the receipts of the super-tax on companies or the corporation profits tax should be allotted to the Provinces is open to certain objections, theoretical as well as practical.

(*a*) In the first place, the problem which the Committee of the League of Nations had to deal with was in some respects different from that which has to be solved in India. The question which that Committee had to consider was not the division of income-tax between a federal Government and the

component States, but the apportionment of income-tax between two sovereign countries. In the case of two independent countries, some weight should probably be given to origin, for every country attempts, by means of protective tariffs, and other means, to develop its industries. It is doubtful whether the same importance should be attached to the principle of origin in considering the question of the division of income-tax between the Provinces in India. To take a concrete case, many of the mining industries and the steel industry are located in the Province of Bihar and Orissa, but the capital of the companies working the mines has been largely supplied by Bombay and Bengal. In the case of the steel industry, a very heavy subsidy is paid by the Government of India, while the other facilities provided by Government are railways, roads, water supply, etc. The railways were, of course, constructed by the Government of India and as regards roads and water supply, the industries pay very heavily in the shape of local taxation. The case for the division of the super-tax on companies among the Provinces is, therefore, not theoretically strong.

(*b*) In the second place, the preliminary adjustment of the collections of each Province to meet the case of profits earned in several Provinces but taxed in only one, which is essential for the distribution of the super-tax on companies on an equitable basis, can only be made on assumptions of a hypothetical character. The complexities of the problem can best be illustrated by taking the concrete case of certain types of companies—

(*i*) Take the case of a Railway company which operates over several Provinces and Indian States and is managed from Bombay and financed by British capital. It would be difficult to state definitely where the income of such a company is earned, how it should be distributed among the various Provinces and on what basis the income should

be assigned to the managing office in Bombay and to the head office in England.

(*ii*) Consider next the case of a big oil company, such as the Burma Oil Company which again is financed largely by British capital and has its head office in England but operates through numerous selling agencies over a large portion of India. It would not be easy in practice to apportion the profits of this company among Burma and the other Provinces where the oil is actually consumed.

It is unnecessary to multiply instances. In the opinion of Sir Josiah Stamp, "the division of profits according to the place of origin presents an almost insoluble problem of accountancy and is, of course, not strictly determinable."

78. The difficulties, however, do not seem to be insuperable and they have been actually overcome in Germany. The problem in India is not as formidable as it was in Germany, for there are at present only about one thousand companies which are subject to this tax and in a very large number of cases the place of collection coincides with the place of earning. The most serious difficulties that stand in the way of such an arrangement would be removed if reasonable agreement could be secured among the Provinces as to the principles of apportionment and a rigid adherence to theoretical principles was not insisted on. In appendix III are given certain instances taken from a report by Messrs. Braithwaite and Minnis of the Board of Inland Revenue illustrating the method by which these difficulties have been overcome in practice in Germany.* From the practical point of view, this tax seems peculiarly suitable for division among the provinces. The proceeds of this tax reflect to a greater extent than the ordinary income-tax the commercial prosperity of the provinces, and Bombay, Bengal and Bihar and Orissa, which are the Provinces that have benefited least by the present settlement, would receive a very large portion of the total amount distributed.

Surcharge on Central taxes.

Possibilities of surcharges on central taxes.

79. The possibility of the levy of surcharges or *centimes additionnels* arises only in regard to the income-tax, for obviously a surcharge on the customs revenue or salt is impracticable. *Centimes additionnels* on the central income-tax are levied in France, Belgium,

*Pages 327-328 of the Appendix to the Final Report of the Departmental Committee on Local Taxation.

Italy and various other European States for local purposes. The possibility of a levy in India was considered by the Taxation Enquiry Committee, who rejected the proposal on the following grounds :—

(1) In their opinion, the system can only be employed successfully where the income-tax machinery is directed to taxing either all revenues at the source or all revenues at the destination of the income and not where a combination of both methods is adopted.

(2) If Provincial Governments were empowered to determine the rates of a surcharge on the Imperial income-tax, an inevitable result would be a variation in the rates in different Provinces which is to be deprecated in the interests of commerce and industry.

80. It may, however, be argued that in coming to this conclusion the Taxation Enquiry Committee were influenced by certain superficial resemblances between the Indian system and the English system. The objection to the levy of a surcharge on the income-tax *collected* within a Province is obvious, but in India, under section 22 of the Indian Income-tax Act, every assessee is required to furnish a return of his income from all sources and under section 29 the Income-tax Officer serves a Notice of Demand on each assessee in which his total income estimated according to the Income-tax authorities is given. There can be no theoretical objection to a system of surcharges, provided such surcharges are levied only on personal incomes of residents within the Province and not on the collections within the Province. Nor would a surcharge on such incomes affect commerce or industry.

The principal objection to such surcharges is that they might encroach seriously on the sphere of Central taxation. This objection would be removed if the surcharges were limited to a definite percentage of the rates prescribed by the Government of India.

Redistribution of the Sources of Revenue.

Possibilities of a redistribution of the Sources of Revenue

81. In the preceding paragraphs the possibility of providing additional income for the Provinces by a division of the existing taxes or by the levy of surcharges on the Central taxes has been discussed. A brief reference may here be made to two Provincial taxes which have not yet been exploited but which are very important sources of income in almost all other civilised countries.

82. A feature which distinguishes the fiscal system of India from that of other

countries is the absence of any internal taxation on tobacco and of any universal taxes on inheritance or succession. The question of the taxation on tobacco through a system of excise has been considered on many occasions by the Government of India, but the proposals have been rejected mainly because there was no organised industry to which it could be applied. The position, however, has altered considerably in recent years because a fairly large cigarette industry has now grown up behind the tariff wall. It would be difficult, however, for Provincial Governments in general to levy an excise duty on cigarettes manufactured in factories, for the manufacture is concentrated in two or three centres, and it would be very difficult to levy the tax according to the principle that duty should follow consumption. Owing to the difficulty of tracing consumption, the tax is in most countries a Central source of revenue. It is therefore a point for consideration whether this source of revenue should not be transferred to the Central Government, especially if some of the Central sources of revenue are to be divided with the Provinces.

83. The question of the levy of death duties in India has been discussed at great length in Chapter XII of the Report of the Indian Taxation Enquiry Committee. Duties on succession are in other countries a common source of Provincial taxation. In the United States of America, both the Federal and the States Governments levy succession duties. In Canada and Switzerland, the Provinces and Cantons alone levy them; while in Australia both the Commonwealth and the States imposed death duties until 1926-27 when it was decided to hand them over wholly to the States. The experience of other countries, therefore, suggests that they are a suitable source of Provincial taxation. There are, however, various reasons which might be urged in favour of making the tax a Central source of revenue. It is closely connected in its nature and administration with the income-tax and, in common with the income-tax, it exhibits the conflict between the claims of origin and residence. In the United States of America a great deal of double taxation has resulted from the fact that the duties levied by the different States are based on different principles. In Switzerland, where most of the cantons impose death duties, it has been found necessary to pass federal legislation to regulate the levy of the tax. In the case of real property, the duty accrues to the canton where it is situated and in the case of personality to the canton where the deceased was domiciled. In India, if death duties were levied, it might probably be necessary to entrust the administration to a Central authority. The

Taxation Committee have also recommended that the legislation dealing with the question of death duties should be undertaken by the Central legislature. The question therefore arises whether this tax should not be transferred to the Central Government and the proceeds divided, as in the case of the income-tax, on certain recognised principles. For instance, the death duties on landed property might be assigned to Provinces and those on personalty to the Central Government.

Contributions.

Possibilities of a system of contributions.

84. It has so far been assumed that the distribution of the sources of revenue should be uniform over provinces. Uniformity, however, for reasons which have already been explained in an earlier portion of the Memorandum, does not necessarily lead to equality, though, it may be noted with interest, the principle of uniformity was enunciated by the Government of India in 1904 as a basis of the quasi-permanent settlements in order "to ensure a reasonable equality of treatment". In practice, as has already been observed, the inequalities then arising were adjusted partly by varying the shares of the divided heads of revenue and partly by a system of contributions. If a partial reversion to a system of divided heads was considered necessary either on the lines indicated in the preceding paragraphs or on some other basis, it might still be possible to vary the shares of the additional taxes according to provincial requirements. Indeed, when the alternatives to Devolution Rule 15 were under discussion, two of the provinces suggested that the rate of income-tax on personal income to be assigned to the provinces might be varied so as to obviate the need for fixed assignments.*

85. The extent to which it might be necessary to resort to a system of contributions will depend upon the decision as regards the principles on which a general distribution of revenue should be effected. It is therefore not possible to deal with the question except in the abstract. As stated in paragraph 55, there are strong objections on theoretical grounds to any system of contributions from the Central Government to the Provincial Governments or from the latter to the former. There is much to be said for a system under which the allotment of certain sources to the Central Government and certain others to the Provincial Governments gives each a revenue adequate to its needs and at the same time effects a fair division between the different provinces.† Practical difficulties, however, often stand in the way of

*See para. 8 of the Report of the Sub-Committee on the division of non-judicial stamps and income-tax, page 120 *infra*.

†Report of the Indian Taxation Enquiry Committee, paragraph 511.

the adoption of the theoretically best system and neither the needs of provinces nor the population of each, to which reference is made in the succeeding paragraph, are criteria which all provinces are likely to accept as the sole principles of deciding what each may fairly expect to retain or to receive. It will be seen from Appendix I, that the constitutions of several federations provide for a system of contributions from the Central Government to the constituent states or provinces as a means of adjusting fiscal inequalities. Australia, however, appears to have recently discarded the system in favour of an arrangement under which certain taxes are shared between the Federal and State Governments on a definite basis though they are collected by a single authority. A similar arrangement is in force in Germany, and the feasibility of adopting it in India has already been discussed in the preceding paragraphs.

Only one extant constitution, *viz.*, that of Switzerland, provides for the levy of contributions by the Federal Government from the constituent States (cantons). But the power has never been exercised in practice, not even during the Great War when the Federal Government was in great financial difficulties.

86. If, however, other alternatives fail and it is found necessary to provide in the Indian constitution of the future for contributions from the Central Government to the Provinces, the question will have to be considered how the aggregate amount of such contributions is to be distributed among the provinces. Federal contributions in aid of the general resources of the constituent states are now paid only in Switzerland and Canada. No details are readily available about the precise arrangement adopted in the former country. In Canada the contributions consist of two parts, *viz.*

(*a*) fixed allowances which vary for the different provinces and are calculated on a scale sliding between a minimum and a maximum with reference to the population ; and

(*b*) fluctuating allowances calculated on a *per capita* basis of population.

In Australia, the Federal Government used to pay until recently contributions to the States on a *per capita* basis of population.

87. From the point of view of the Central Government, a system of fixed contributions seems to offer the advantage of avoiding any subsequent disturbances in the financial dispositions of that Government. From the point of provinces, a system of fixed *plus* fluctuating contributions has the advantages of securing to the

provinces a minimum allowance whatever the vicissitudes of the province may be and of holding out a prospect of increased resources which may, according to the basis of calculation, in greater or less degree, be related to increased demands for expenditure. What method is adopted, it will still be for decision whether the conclusions reached should find a place in the rigid portion of the constitution or should be given a more fluid form whether in the statutory rules or otherwise. The advantages of the former method are that any disputes between the Central Government and the Provincial Governments will be obviated and any attempt on the part of the former to utilise the contributions as a means of influencing the policy and administration of the latter outside the provisions of the constitution will be prevented. The advantages of the latter method are the greater facility for amending financial inequalities and adjusting the incidence of the working of the financial settlements as experience proves necessary. The history of the Meston Settlement suggests that any financial settlement may have, in the course of its operation, consequences which could not be foreseen at its inception.

Conclusion.

88. This Memorandum is confined to a single problem, *viz.*, the distribution of the existing sources of revenue between the Central Government and the Provincial Governments under the present constitution. It proceeds on the assumption that the method of allocation of revenues to Provincial Governments, on which the Meston Settlement is based, will be maintained; but the validity of this assumption will depend on certain general considerations which will govern the determining features of the new constitution and which will require separate examination. Its scope is further limited by certain practical considerations such as those indicated in paragraph 53. As has been observed, under the present system it would be difficult to provide the Provinces with additional funds, except by the sacrifice of Central revenues, existing or potential. By a slight re-distribution of the sources of income on the principles indicated in the last portion of the memorandum, it might be possible to remove some of the more obvious inequalities of the present system and to make the distribution more equitable as between the Provinces. But a revision of the Meston Settlement, even on the lines suggested by the discontented Provinces, would not give these Provinces more than one or two crores of rupees. With the wider and more important problem of finding the colossal sums of money required for universal mass education (estimated at not less than Rs. 60

crores for the whole of India) and for rural development, it is not proposed to deal here, for the question of fiscal development cannot be discussed in isolation. To give an instance, the Taxation Committee have come to the conclusion that the chief impediment in the way of the development of local taxation arises from the fact that the jurisdictions of local authorities in this country are so large as to remove them from effective touch with the taxpayer. The Committee have therefore strongly endorsed, on purely fiscal grounds, the recommendation of the Decentralisation Commission, based on administrative considerations, that the unit of local administration should be the village. It is obvious that questions such as these raise constitutional and administrative issues which cannot be adequately discussed here

July 1928.

Statements showing the financial position of Provinces.

MADRAS.

Lakhs of Rupees.

Year.	Revenue position.			Debt position.					Closing balance after adjusting capital and miscellaneous transactions.	
				Loans in open market.	Loans from Government of India or Provincial Loans Fund					
	Revenue.	Expenditure.	Surplus + or deficit —		Opening balance.	Borrowings.	Repayments.	Closing balance	Ordinary balance.	Famine Insurance Fund.
1921-22 ..	11,75	12,74	—99	.	9,85	1,15	10	10,90		..
1922-23 ..	12,58	12,61	—3	..	10,90	66	14	11,42	3	6
1923-24 ..	12,99	12,63	+36	.	11,42	61	45	11,58		13
1924-25 ..	12,79	13,09	—30	..	11,58	1,30	22	12,66	17	14
1925-26 ..	14,71	13,73	+98	..	12,66	89	30	13,25	1,23	21
1926-27 ..	15,18	14,17	+1,01	..	13,25	2,02	34	14,93	2 81	29
1927-28 (revised).	16,76	15,58	+1,18	..	14,93	1,60	40	16,13	3.57	37
1928-29 (budget).	16,97	16,99	—2	..	16,13	1,45	46	17,12	2,43	44

BOMBAY.

Lakhs of Rupees.

Year.	Revenue position.			Debt position.							Closing balance after adjusting capital and Miscellaneous transactions.	
				Loans raised in open market.			Loans from the Government of India or Provincial Loans fund.					
	Revenue.	Expenditure.	Surplus + or deficit —.	Opening balance.	Borrowings.	Closing balance.	Opening balance.	Borrowings.	Repayments.	Closing balance.	Ordinary.	Famine Insurance Fund.
1921-22 ..	13,11	15,02	—1,91	9,39	..	9,39	12,12	3,80	10	15,62	2,14	..
1922-23 ..	14,17	13,53	+ 64	9,39	..	9,39	15,82	7,65	34	23,13	3,73	61
1923-24 ..	14,52	14,23	+ 29	9 39	..	9,39	23,13	10,25	29	33,09	4,88	94
1924-25 ..	14,99	14,72	+ 27	9,39	..	9 39	33,09	7,05	30	39,84	5,24	1,44
1925-26 ..	15,24	16,15	— 91	9,39	..	9 39	39,84	6,58	75	45,67	5,39	1,95
1926-27 ..	14,58	16,24	—1,66	9,39	..	9,39	45,67	2 62	70	47,59	2,82	2,42
1927-28 (revised) ..	15,53	15,99	— 46	9,39	..	9,39	47,59	2,91	80	49,70	74	1,81
1928-29 (budget) ..	15,74	16,13	— 39	9,39	..	9 39	49,70	4,23	2,67	51,26	7	1,62

Statements showing the financial position of the Provinces – *contd.*

BENGAL.

Lakhs of Rupees.

Year.	Revenue position			Debt position.					Closing balance after adjusting capital and miscellaneous transaction.	
				Loans raised in open market	Loans from the Government of India or Provincial Loans Fund					
	Revenue	Expenditure.	Surplus + or deficit —		Opening balance.	Borrowings	Repayments.	Closing balance	Ordinary	Famine Insurance Fund.
1921-22 ..	8,32	10,48	—2,16	.	1,18	50		1,68	65	2
1922-23	9,85	9,59	+26		1,68	52	2	2,18	87	4
1923-24 ..	10,13	9,78	+35		2,18	..	4	2,14	1,24	6
1924-25 .	10,34	9,76	+58		2,14		5	2,09	1,86	8
1925-26 .	10,70	10,31	+39	.	2,09	24	5	2,28	2,27	11
1926-27 ..	10,50	10,71	—21	.	2,28	7	5	2,30	1,86	13
1927-28 (revised)	10,77	11,03	—26	.	2,30	24	6	2,48	1,74	13
1928-29 (budget).	10,93	11,24	—31	.	2,48	39	6	2,81	72	12

UNITED PROVINCES.

Lakhs of Rupees.

Year.	Revenue position.			Debt position.							Closing balance after adjusting capital and miscellaneous transactions.	
				Loans raised in open market.			Loans from the Government of India or Provincial Loans Fund.					
	Revenue.	Expenditure.	Surplus + or deficit —	Opening balance.	Borrowings.	Closing balance	Opening balance.	Borrowings	Repayments.	Closing balance.	Ordinary balance.	Famine Insurance Fund.
1921-22	10,02	11,49	—1,47	..	4,19	4,19	15,16	23	48	14,91	2,70	32
1922-23	10,06	10,71	—65	4,19	1	4,20	14,91	..	25	14,66	83	58
1923-24	10,31	10,47	—16	4,20	.	4,20	14,66	1,04	25	15,45	54	90
1924-25	10,00	10,43	—43	4,20	..	4,20	15,45	1,48	25	16,68	26	49
1925-26	10,87	11,18	—31	4,20	..	4,20	16,68	2,00	25	18,43	22	30
1926-27	11,39	11,34	+5	4,20	..	4,20	18,43	2,27	26	20,44	..	20
1927-28 (revised) ..	12,83	11,71	+1,12	4,20	..	4,20	20,44	1,94	92	21,46	21	6
1928-29 (budget) ..	12,47	11,92	+55	4,20	..	4,20	21,46	2,25	27	23,44	22	20

Statements showing the financial position of the Provinces—*contd.*

PUNJAB.

Lakhs of Rupees.

Year.	Revenue position			Debt position							Closing balance after adjusting capital and miscellaneous transactions.	
				Loans raised in open market			Loans from the Government of India or Provincial Loans Fund.					
	Revenue.	Expenditure.	Surplus + or deficit—.	Opening balance.	Borrowings.	Closing balance	Opening balance.	Borrowings.	Repayments.	Closing balance.	Ordinary balance	Famine Insurance Fund.
1921-22	7,10	8,81	—1,71	..			21,86	1,00	.	22,86	.	..
1922-23 .. .	8,28	8,85	—57	.	.	.	22,87	1,32	.	24,19	..	4
1923-24 . .	9,16	8,04	+1,12	.	192	1,92	24,19		1,00	23,19	64	8
1924-25 .	9,78	7,95	+1,83	1,92	.	1,92	23,19		1	23,18	1,30	11
1925-26	11,52	9,94	+1,58	1,92	73	2,65	23,18	..	1	23,17	2,54	14
1926-27 ..	10,86	11,47	—61	2,65	16 —1	2,80	23,16	.	1	23,15	1,45	14
1927-28 (revised) ..	12,42	12,07	+35	2,80	..	2,80	23,15	30	1	23,44	1,31	18
1928-29 (budget) .	12,73	12,77	—4	2,80	.	2,80	23,44	40	2	23,82	89	20

BURMA.

Lakhs of Rupees.

Year.	Revenue position.			Debt position.					Closing balance after adjusting capital and miscellaneous transactions.	
				Loans raised in open market.	Loans from the Govt. of India or the Provincial Loans Fund.					
	Revenue.	Expenditure.	Surplus + or deficit—.		Opening balance.	Borrowings.	Repayments.	Closing balance.	Ordinary balance.	Famine Insurance Fund.
1921-22 ..	9,18	9,04	+14	*Nil.*	..	..	..	..	5,84	1
1922-23 ..	8,68	10,24	—1,56		..	..	..	..	3,67	1
1923-24 ..	8,58	8,85	—27		..	..	..	..	3,03	1
1924-25 ..	9,86	9,87	—1		..	..	..	..	2,78	1
1925-26 ..	10,19	10,80	—61		..	..	..	..	2,41	2
1926-27 ..	10,06	11,42	—1,36		..	..	..	..	1,04	3
1927-28 (revised)	10,34	12,10	—1,76		..	85	..	85	9	3
1928-29 (budget)	10,73	11,78	—1,05		85	1,50	2	2,33	12	4

Statements showing the financial position of the Provinces—*contd.*

BIHAR AND ORISSA.

Lakhs of Rupees.

Year.	Revenue position.			Debt position.					Closing balance after adjusting capital and miscellaneous transactions.	
				Loans from open market.	Loans from the Government of India or the Provincial Loans Fund.					
	Revenue.	Expenditure.	Surplus+ or deficit—.		Opening balance.	Borrowings.	Repayments.	Closing balance.	Ordinary balance.	Famine Insurance Fund.
1921-22 ..	4,43	4,58	—15	..	6,69	..	5	6,64	85	8
1922-23 ..	4,94	4,63	+31	..	6,64	20	5	6,79	1,21	22
1923-24 ..	5,28	4,84	+44	..	6,79	7	5	6,81	1,43	33
1924-25 ..	5,36	5,13	+23	..	6,81	5	5	6,81	1,61	41
1925-26 ..	5,79	5,55	+24	..	6,81	..	25	6,56	1,68	56
1926-27 ..	5,74	6,05	—31	..	6,56	..	7	6,49	1,28	65
1927-28 (revised)	5,65	5,94	—29	..	6,49	..	7	6,42	97	69
1928-29 (budget)	5,74	5,88	—14	..	6,42	..	8	6,34	75	76

CENTRAL PROVINCES.

Lakhs of Rupees.

Year.	Revenue position			Debt position.					Closing balance after adjusting capital and miscellaneous transactions.	
				Loans in open market	Loans from Government of India or Provincial Loans Fund.					
	Revenue.	Expenditure.	Surplus + or deficit—.		Opening balance.	Borrowings.	Repayments.	Closing balance.	Ordinary balance.	Famine Insurance Fund.
1921-22 ..	4,72	4,95	—23	..	4,64	47	4	5,07	..	...
1922-23 ..	5,16	4.90	+26	..	5,07	29	43	4,93	47	31
1923-24 ..	5,17	4,94	+23	..	4,93	31	6	5,18	1,00	72
1924-25 ..	5,25	4,88	+37	..	5.18	26	28	5,16	1,31	1,14
1925-26 ..	5,35	5,33	+2	..	5,16	13	25	5,04	78	1 51
1926-27 ..	5,07	5.74	—67	..	5,04	32	8	5,28	..	1,87
1927-28 (revised)	5,47	5,39	+8	..	5.28	82	12	5,98	47	1,79
1928-29 (budget)	5,54	5,68	—14	...	5,98	32	10	6,20	15	1,72

Statements showing the financial position of the Provinces—*concld.*

ASSAM.

Lakhs of Rupees.

Year.	Revenue position.			Debt position.					Closing balance after adjusting capital and miscellaneous transactions.	
				Loans raised in open market.	Loans from the Government of India or the Provincial Loans Fund.					
	Revenue.	Expenditure.	Surplus+ or deficit—.		Opening balance.	Borrowings.	Repayments	Closing balance.	Ordinary balance.	Famine Insurance Fund.
1921-22 ...	1,82	2,05	—23	*Nil.*	...	...	...	..	7	...
1922-23 ...	1,84	2,05	—21		...	13	...	13	...	...
1923-24 ...	2,11	1,90	+21		13	...	...	13	23	...
1924-25 ...	2,30	2,00	+30		13	..	13	..	44	...
1925-26 ...	2,50	2,28	+22		...	..	..	...	64	1
1926-27 ...	2,43	2,43	..		...	...	...	...	63	1
1927-28 (revised)	2,68	2,58	+10		...	...	...	...	67	1
1928-29 (budget)	2,78	2,82	—4		...	...	...	...	49	1

APPENDIX I.

SWITZERLAND.*

1. The Swiss federation may be taken as representing one extreme, that is to say, a federation of states of markedly independent characteristics which existed as independent authorities long before they joined in the federation. Not only were the cantons organized political bodies, but in some cases at least the communes, which compose the cantons, had also independent existence and did not derive their authority from the latter. These factors have led to an emphasis of the importance of the cantons, which view with considerable jealousy any attempt on the part of the Federation to encroach upon the sphere of the cantons.

2. Under the Swiss constitution, the Federal Government is entitled to the revenue from the following sources :—

(1) Federal property.

(2) Customs.

(3) Posts and Telegraphs.

(4) The powder monopoly.

(5) Half of the gross receipts from the tax levied by the cantons in return for exemptions from Military service.

(6) Contributions by the cantons to the Federal Government.

Before the War the revenues of the Federation, which were about one hundred million francs, were derived mostly from State property and customs duties and there was very little income from direct taxation. The revenue of the cantons, which amounted to more than two hundred million francs, was mostly derived from the following taxes :—

(1) Income-tax, property tax and personal taxes.

(2) Death duties and succession taxes.

(3) Stamps.

(4) Various forms of indirect taxes such as taxes on carriages, automobiles, etc.

The cantons also received 12 million francs as their share of federal taxes and about 24 millions in subventions from the Federal Exchequer.

3. Under section 42 of the Swiss constitution, in times of emergency the cantons are required to contribute to the expenses of the Federation according to a prescribed scale, but in practice no such contributions have been paid. When the Federal Government was faced with heavy expenditure for mobilisation in connection with the outbreak of the War, it imposed temporary war taxation on property and income to be levied by the cantons, which retained a share of the proceeds and paid the balance into the Federal treasury. When the measure was introduced, it was explained that, though, under the

*The account of the fiscal system of these federations is largely based on—

(1) a note prepared for the Taxation Committee

(2) Newton's Federal and Unified Constitutions and

(3) Official Year Books of Canada, Australia and S. Africa.

constitution, the proper course was to levy contributions on the cantons, it would be entirely contrary to the custom of the constitution to make such a levy, since the tendency had been for the Federal Government to give contributions to the cantons and the finances of the latter would be dislocated if they made contributions. Consequently the constitution was amended and a direct federal war tax was levied. As the War went on, a war-profits tax was introduced, then a second levy of war tax and finally an increase in stamp duties and customs. In 1924, the Federal revenues amounted to 350 million francs, of which 268 millions represented taxation. The total revenues of the cantons amounted in that year to 510 million francs, distributed as follows :—

	Million francs
(1) Cantonal direct taxation and death duties	198
(2) Stamps, licenses and permits	39
(3) Share of federal taxes ..	26

The balance consisted of ordinary and extraordinary subventions and income from property. The Cantons and the Federation now share the income from military taxes, patent fees, the alcohol monopoly, the profits from the National Bank, the stamp duties and, to a certain extent, the yield of the War taxes.

Certain functions are imposed upon the Cantons by law, but their discharge is conditional upon the grant of subsidies by the Federation. Subsidies are also utilized for co-ordinating the activities of the Federation and the Cantons in certain matters. The total subsidies from the Federation to the Cantons amounted to 24.2 million francs in 1913 and to 57.5 million francs in 1927.*

It will thus be observed that the system of subsidies is a prominent feature of Swiss financial arrangements. There appear to be no general subsidies and the normal subsidies are all for specific objects such as roads, forestry, agriculture, public health, education, etc. The extraordinary subsidies were chiefly for measures of unemployment relief and reduction in the cost of living. It does not, however, appear that the subsidies have been used as a balancing factor between the Federal and cantonal finances.

The German Empire.

4. Prior to the adoption of the constitution of 1871, various forms of federation had been in force in Germany. The main conditions under which this constitution was framed were the preponderant position of Russia and the unifying influence of the Zollverin or Customs Union. The provisions of the 1871 constitution, which relate to taxation, were as follows :—

Among the affairs which were subject to the superintendence and legislation of the Empire were customs and commercial legislation, taxes which were to be applied to the requirements of the Empire, banking and overseas trade. In section 33, it was provided that Germany should form one commercial territory encircled by a

*Memorandum on Public Finance 1922-26—League of Nations.

common frontier. Articles of free trade in one of the States might be introduced into any other State and could only be subjected to a duty in the latter when *and to the same extent as similar articles produced in that State were subject to a home duty. Section 35 gave the Empire the sole right of legislation in all customs affairs, in the taxation of salt and tobacco, beer, spirits and sugar. These taxes were to be collected and administered by the States, but the revenue from them went into the Imperial treasury subject to a deduction for the cost of collection.

5. In the nineties, the German States adopted the income-tax and a little later, they also adopted inheritance taxes levied at progressive rates. At this stage, the Federal Government did not levy direct taxation, but derived its revenue from the taxes which have already been specified. As this revenue was not sufficient for the needs of the Federal authority, it was provided that the balance should be met by contributions from the States. After 1879, the increase in the customs duties provided the Empire with more money than it needed, but, largely for political reasons, the contributions were not abolished. Instead, a complicated arrangement was adopted by which the surplus of certain revenues was allotted to the States. The contributions were set off against them, and any surplus of allotments over contribution was paid to the States.

6. In the early years of the twentieth century, the increasing needs of the Imperial Government led to the adoption of a number of new Federal taxes on consumption and transactions, and in 1906, a federal inheritance tax was introduced. The tax was actually levied by the States subject to the Federal law governing double taxation. Two-thirds of the yield of the inheritance tax was to go to the Empire and one-third to the several States, which were now to abandon their own inheritance taxes. A few years later, the expenditure on the navy necessitated a readjustment of the system and it became necessary to raise additional federal revenue to the extent of 500,000,000 marks a year. It was originally proposed to raise 400,000,000 marks by indirect taxation and the balance from an increase in the rates or scope of the inheritance tax. But ultimately, 475,000,000 marks were raised from taxes on consumption and on transactions, and 25,000,000 by a slight increase in the contributions and by the assignment to the Empire of three-fourths instead of two-thirds of the existing inheritance tax. This system remained in force until the outbreak of the War. In 1913, an Imperial income-tax was levied for the first time, but not as an annual tax. The fact that there was no Imperial income-tax caused considerable inconvenience during the War.

7. The revolution of November 1918 brought about the framing of a new constitution, of which the principal provisions relating to taxation are as follows:—

*The Federal Government has sole legislative power in the matter of customs and as regards both uniformity in the sphere of customs and trade and freedom of commercial intercourse. Under article 8, the Federal Government is

*Newton's Federal and Unified Constitutions.

given legislative power as regards taxes and other sources of revenue so far as they are claimed, wholly or in part, for federal purposes Where the Federal Government demands taxes or other sources of revenue hitherto appertaining to the various States, it must take into consideration the maintenance of the vitality of those States. Under article 11, the Federal Government is given power to draw up regulations as to the admissibility and mode of collection of State taxes in so far as they are required for the purpose of preventing—

(1) loss of revenue or action prejudicial to the commercial relations of the Federation,

(2) double taxation,

(3) the imposition of charges for the use of the public lines of communication which constitute a hindrance to traffic.

(4) the grant of bounties on exportation, or

(5) assessments prejudicial to imported goods as opposed to home products in dealing between the separate States

8. In article 82, the provisions of article 33 of the 1871 constitution are reproduced, and article 83 provides that customs duties upon articles of consumption should be administered by the Federal authorities. Article 84 allows the Federal Government to pass laws regarding the organisation of the administration of the taxes in the States so far as is required for the purposes of uniform and equal execution of the Federal laws of taxation. The 1919 constitution gave the Federation full financial hegemony and entitled it to impose taxes without restriction. Instead of contributions from the individual States to the Empire, the Federation has now the power to permit the States to share in the yield from certain taxes and to give various grants-in-aid to them.

9. The actual distribution of the principal heads of taxation in force in 1924 was as follows :—

The federation levied and appropriated exclusively the following rates : Tax on capital, capital increment tax, inheritance tax, tax on debentures, company flotations, stock-exchange turn-over, director's fees, bills of exchange and transport, lottery tax, insurance tax, consumption tax on sugar, salt, tobacco, beer, wine, lighting materials, playing cards and acetic acid, import and export taxes, and monopolies. The income-tax and corporation tax were divided between the Federation and the States in the proportion of 10 per cent. to the former and 90 per cent. to the latter, while the turn-over tax was also divided in the proportion of 80 per cent. to the Federation and 20 per cent. to the States. The States took the whole yield of the tax on landed property and buildings, taxes on carriages and motor cars, betting taxes, bourse tax and stamp duties.

10. In 1922-23, the proceeds of the taxes which were divided amounted to almost exactly half of the total revenue. The fractions of the divided taxes are not laid down by law, but are liable

to variation. The change to the new system encountered considerable opposition from the States, and it was only the serious financial difficulties of the Republic that secured acquiescence. In August 1925, a revision of the arrangements was carried out, as a result of which the States obtain 75 per cent. of the yield of the income and property taxes, and 25 per cent of that of the turn-over tax A minimum assignment to the States is guaranteed, and if the prescribed fractions of the divided taxes do not yield the minimum, the Federal Government makes up the required amount For the present, the guaranteed minimum is M. 2,100 million, which is almost exactly one-third of the Federal tax-revenue

The financial power of the Reich is thus unlimited. The States have only those financial resources which the Reich allows to them and any source of state revenue already existing may be abolished or appropriated by the Reich, subject only to the condition contained in article 8 of the Constitution which reads—

> " Should the Reich appropriate to itself any taxes or other revenues, which have hitherto belonged to the States, it shall take into consideration the necessity of ensuring to the States their means of existence ".

UNITED STATES OF AMERICA.

11 The United States of America furnish another example of the type of federation whose constituent states enjoy a large measure of fiscal and political independence. The provisions of the original constitution which bear upon taxation are briefly as follows* :—

(1) All direct taxes shall be apportioned among the several States according to their respective numbers to be determined in the manner prescribed in the section. (Article 1, Section II.)

(2) The Congress may levy and collect taxes, duties, imposts and excises to pay the debts and to provide for the common defence and general welfare of the United States but all such duties, imposts and excises shall be uniform throughout the United States. The Congress also shall have power to regulate commerce with foreign nations and among the several States

3) No capitation or other direct tax shall be levied " unless in proportion to the census or enumeration hereinbefore directed to be taken ". (Section IX.)

(4) No tax or duty shall be levied on articles exported from any State. (Section IX.)

(5) No preference shall be given by any regulation to commerce and revenue of one State over those of another. (Section IX.)

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*Newton's Federal and Unified Constitutions, pages 80—99.

(6) No State shall, without the consent of the Congress, levy any imposts or duties on imports or exports except what may be absolutely necessary for executing its inspection laws; and

the net proceeds of all duties and imposts allowed by any State on imports or exports shall be for the use of the treasury of the United States and all such laws shall be subject to revision and control of the Congress. (Section X.)

(7) "Powers (including of course those of taxation) not delegated to the United States by constitution nor prohibited by it to the States are reserved to the States respectively or to the people".

12. These provisions led in practice to the result that the Federal Government only was in a position to levy taxes on consumption while the States were given the exclusive right of levying direct taxation, using the word 'direct' as understood in America. The States could in theory levy indirect taxes or excises but could not in practice do so, since, under the constitution, all the States would have to levy the same duty. Again it was open to the Federal Government to levy an income-tax if that was held to be a direct tax, but it must be apportioned in the manner prescribed and the consequent inequality of taxation between persons with the same income in different States rendered the tax impossible An Income-tax Act was passed by the Federal Government during the Civil War and the income-tax was then held to be not a direct tax, but when a similar tax was introduced in 1885, the Supreme Court declared it unconstitutional as a direct tax. The distribution of taxation in the United States until about 1913 was briefly as follows :—

(a) The Federal Government raised the whole of its revenue from customs duties and internal revenue. The latter head consisted mainly of excises on articles of consumption, but it also included succession duties (which, according to American law, are not classed as direct taxes) and certain taxes on transactions.

(b) The States relied for their revenue on the general property tax, inheritance duties and taxes on corporations and also derived a small income from liquor and other licenses and a poll tax. In some States income-taxes were also in force.

The defects of the general property tax and the difficulties in connection with the State income-taxes led to a movement for the imposition of a Federal income-tax. In 1913, the sixteenth amendment of the constitution was adopted, which ran as follows :—

"The Congress shall have power to levy and collect taxes on incomes from whatever source derived without apportionment among the several States and without regard to any census or enumeration".

After the adoption of this amendment, a Federal income-tax was introduced and large sums were raised by it during and after the

War. According to the Estimates for 1928, the Federal revenue from different taxes is as follows :—

	Million dollars.
Customs	601.8
Internal revenue including excises and succession duties ..	569.0
Income-tax	2,090.0

Subventions and grants are paid by the Federal Government to the States for specified purposes.

CANADA.

13 The form of the Canadian Federation was very definitely influenced by the conditions under which it arose. The legislative union of Upper and Lower Canada involved such rivalry between the two sections of the province that a unitary government was impossible, and its replacement by a federal union was seen to be the inevitable solution of the problem of Canadian government. At the same time, the other colonies in British North America were anxious for a form of union which would lead to greater strength. The whole movement was profoundly influenced by the American Civil War which was then proceeding, and threatened, on the one hand, war between the United Kingdom and the United States of America and on the other brought into relief those features of the Constitution of the United States which had led to the struggle Sir J. A Macdonald, one of the principal advocates of the union, indicated his preference for a legislative union, and although the disinclination of the Colonies to lose their individuality prevented this solution, the form which the British North America Act ultimately took, emphasised the predominant position of the Dominion Government as against the provinces Consequently, the Constitution proceeds on the basis of defining the sphere of the provincial Governments and leaving the residuary power to the Dominion Government. So far as this principle affects the division of taxation, the result is as follows :—

Under section 92 of the Constitution, the following among other subjects are assigned to the provinces :—

(1) Direct taxation within the province for provincial purposes,
(2) Public land belonging to the province,
(3) Prisons and hospitals,
(4) Municipal institutions,
(5) Licenses for the purpose of revenue,
(6) Local works, and
(7) Administration of justice (but not criminal procedure).

The central Government may raise money by any mode of taxation, and may tax the same subjects as the provinces, though it does not appear to have done so. The regulation of trade and commerce is reserved exclusively to the federation

14. At the time of federation, the central Government took the customs and excise duties, while provincial lands and mines were assigned to the Provinces in which they were situated. The Provincial debts were assumed

by the central Government. Provision was made, however, for a yearly subsidy from the central Government, partly on the basis of population. These subsidies were revised by the Act of 1907, under which each Provincial Government now receives—

(*a*) a fixed grant according to population, and

(*b*) a grant at the rate of 80 cents. per head of the population up to 7½ millions and at the rate of 60 cents. per head of so much of the population as exceeds that number.*

15. Until the Great War, the customs and excise duties constituted the chief source of revenue of the Dominion Government for general purposes. During the War, the Federal Government resorted to direct taxation—a power which it had always possessed but had not hitherto had occasion to use. In 1916, a business profits war tax was imposed, in 1917 an income-tax and in 1920 a sales tax. The relative financial position of the Federal Government and the Provinces in 1925 was as follows :—

DOMINION GOVERNMENT.

	Million dollars.
Customs . . .	108.0
Excise . . .	38 6
War Tax Revenue (*i.e.*, sales, etc., taxes) .	147 0
Post Office . . .	28.8
Other sources . .	29.0
	351.4

ALL PROVINCES.

	Million dollars.
Fees	5.2
Subsidies	13.7
Lands, Mines and Forests .	16.7
Succession duties . .	10.8
Corporations Taxes . .	26.2
Licenses	27.8
Other items	32.0
Total . .	132.4†

AUSTRALIA.

16. The Commonwealth of Australia is the second oldest federation in the British Empire and is a type of union very different from that of Canada. In introducing the Commonwealth of Australia Bill in Parliament, Mr. Joseph Chamberlain, after pointing out that the Bill would give the six colonies a common tariff, common communications and a common form of national defence, went on to say that the

*Page 774 The Canadian Year Book for 1926.
†Canadian Year Book. 1926.

constitution was modelled on that of the United States of America. The separate colonies had enjoyed for so long such great powers that they were naturally unwilling to part with them to any large extent. The federation created was for distinctly definite and limited objects and State rights had throughout been jealously preserved.

Under sections 106 and 107 of the Constitution, powers enjoyed by States are held to continue unless exclusively vested in the Commonwealth Parliament or withdrawn from the State Parliament by the terms of the Constitution. The only powers affecting taxation which are exclusively vested in the Commonwealth are the powers of levying duties of customs and excise. Under section 51, the Commonwealth is given power to legislate with respect to trade and commerce or to taxation, but so as not to discriminate between States; and to give bounties on production or export under the same proviso. This however does not impair the States' power of legislation on these subjects, though under section 109, when a State law is inconsistent with a Commonwealth law, the latter prevails.

17. The distribution of taxes between the Commonwealth and the States was as follows in 1924-25 :—

	£
COMMONWEALTH.	
Customs . . .	26,405,161
Excise . . .	10,787.620
Land Tax . . .	2,519,711
Estate Duty . . .	1,381,051
Income Tax . . .	11,136,344
Entertainments Tax .	680,586
War Time Profits Tax .	74.784
ALL STATES.	
Probate and succession .	2,767,987
Other stamp duties .	3,688,165
Land Tax . . .	1,300,374
Income Tax . . .	12,014,662
Licenses . . .	842,872
Other Taxation . .	1,055,977

18. It will be noticed (1) that all the direct taxes were levied both by the Commonwealth and the States, and (2) that with the possible exception of stamp duties, all indirect taxation was taken by the Commonwealth.

The rates of succession duties and income-tax differed widely in the different States. It would seem that the division of resources, as between the Commonwealth and the States, had not worked out satisfactorily. In 1923 a conference was held between the Commonwealth and State Ministers with the object of terminating the subsidy system and of simplifying the taxation systems. The first proposal was to divide the field of income-tax, the Commonwealth vacating the field of taxation of incomes below £2,000 and discontinuing the payment of subsidies. This was not accepted by the States, who wished to appropriate the whole of the income-tax. Ultimately, the majority of the States accepted a modified scheme according to which the Commonwealth retained only the right to tax

companies up to a maximum limit of 2s. 6d. in the pound. Pending the introduction of the scheme, it was arranged that the State taxation officers should collect both the State and Federal income-taxes, except where the income is derived from more than one State.

In accordance with this arrangement, by the end of June 1924, a system was inaugurated under which the Commonwealth Central Taxation Office assessed Commonwealth income-tax on all tax-payers whose income was derived from more than one State, while in New South Wales, Victoria, South Australia, Queensland and Tasmania, the State Commissioner of Taxation, who is also Federal Deputy Commissioner, assessed both the Commonwealth and State income-taxes. In Western Australia, the Federal and State Taxation Departments had been amalgamated in 1924.

In 1926-27, a new arrangement for the division of the proceeds of direct taxation between the Commonwealth and the States came into force.

The proceeds of the direct taxes collected by the Commonwealth during 1926-27 were divided as follows between the Federal Government and the States :—

	£(000's omitted.)		
	Total.	Commonwealth.	States.
Land tax	2,311	200	2,111
Income-tax	10,506	6,450	4,056
Estate duty ..	1,350	50	1,300
Entertainment tax..	370	50	320
	14,537	6,750	7,787

The amount of £1,00,000 allotted in 1926-27 to the Commonwealth from the proceeds of the Estate duty and entertainments tax consisted entirely of arrears of assessment for the previous year. The proceeds of these two taxes were to be handed over to the States from 1926-27.

19. The Australian system of taxation has two special points of interest. The first is that in the sphere of direct taxation no attempt is made to separate the sources of taxation. The proceeds of the income-tax, and land tax are divided between the Commonwealth and the States.

The other feature is the system of subsidies. In the original Constitution, under the 'Braddon Clause' (section 87) the subsidies took the form of an allotment to the States of three quarters of the customs and excise duties. This arrangement terminated in 1910-11. It was found that the absence of responsibility on the part of the States for raising the money was unsatisfactory and the arrangement was, therefore, replaced by a system of *per capita* subsidies paid out of surplus revenue. But this system too has been found to be defective and one of the reasons for the proposals to divide the field of income-tax between the Commonwealth and the States was the desire to get rid of the contribution system.

These *per capita* payments have been abolished as from 30th June 1927 under the States Grant Act passed in that year. It was also agreed that, subject to ratification by the Commonwealth and State Parliaments, the Commonwealth should

take over all State debts existing on 30th June 1927, pay £7.6 million for 58 years towards interest charges thereon and make substantial contributions towards a sinking fund to extinguish existing debts in 58 years and future debts in 53 years.

SOUTH AFRICA.

20. In the latest combined Government under the Crown, the Union of South Africa, the functions of the provinces are more circumscribed than those of the Australian Colonies. These organisations have no parliaments, only provincial Councils, and they pass ordinances, not laws. Under the British South Africa Act, 1909, the provincial Councils have the following main legislative powers :—

Direct taxation for provincial purposes.

Education, other than higher education.

Agriculture.

Hospitals.

Municipal institutions.

Local works, other than railways and harbours.

Markets and pounds.

Game preservations.

Up to the year 1913, the provinces had no revenues of their own and their expenditure was met by subsidies from the Union Government. By the Financial Relations Act 10 of 1913, the following sources of revenue were transferred, with powers of legislation, to the provinces ; hospital and education fees, totalizator duties, auctions dues, dog, game and profession licenses and liquor licenses. Subsequent Financial Relations Acts have transferred, among other matters, the following : libraries and museums, poor relief, shop hours, licensing of vehicles on provincial roads, betting, racing and amusements. The total revenue of all the provinces in 1922-23, excluding subsidies was £3,561,443, while the subsidies amounted to £4,167,266. The revenue of the Union in the same year was £27,234,515.

21. The taxation revenue of the provinces is derived from a number of simple direct taxes. Those common to all provinces are :—

Transfer duty—a tax on sales of real property, liquor licenses, licenses—general and entertainment tax.

Those found in one or other of the provinces are :—

Native pass fees, totalizator tax, auction dues, poll tax, wheel tax and companies tax.

All the main taxes such as customs, excise, income-tax, state and succession taxes, stamp duties, licenses and native taxes and land revenue are levied by the Union.

22. The subsidy system in South Africa appears to have led to inefficiency in the administration. The first settlement, that of 1913, proceeded on the basis of allotting certain revenues to the provinces and of making a grant equal to one-half of the normal expenditure. A committee, which was appointed in 1922, reported that the payment of subsidies on this basis was unsound, and in particular, had led to an unnecessary increase of expenditure on education,

that taxes in the shape of auction dues, poll tax, trade and occupation licenses, company tax and employer's tax were suitable for the provinces, which should also be given complete control of transfer duties, liquor licenses, motor taxes, wheel taxes, totalizator and betting taxes and the immovable property tax. The Committee further recommended that the Union subsidy should take the form of a grant-in-aid for education, fixed according to the number of pupils and that trade and occupation licences should be uniform throughout the Union.

23. In 1925 an Act was passed to regulate the financial relations between the Union and the constituent Provinces. The principal feature of this Act (No. XLVI of 1925) are as follows:—

(1) The subsidies to the Provinces for educational purposes will be fixed according to the number of pupils attending schools established by the Province and will be paid on the basis of the educational statistics for the preceding year. The Governor-General has power to make regulations governing the payment of these grants and the method to be employed in preparing the educational statistics on which the grants are based.

(2) The conditions subject to which loans may be given to the Province or Provinces may be allowed to borrow in the market were laid down.

(3) The revenues from the following taxes, fees, dues and licenses were definitely assigned to the Provinces :—

(*a*) Hospital fees.

(*b*) Licenses for dogs, motors, etc.

(*c*) Tax on vehicles.

(*d*) Amusement or Entertainment tax.

(*e*) Auction duties.

(*f*) Licensing of totalisators and other taxes on betting.

(*g*) Taxes on persons other than companies and on the incomes of persons other than companies, subject to certain limits specified in the Act.

(*h*) A tax on companies other than mutual life insurance companies subject to certan limits specified in the Act.

(*i*) A tax on the ownership of immovable property but not on transfers or sales thereof.

(*j*) Licenses in respect of the importation for sale within the Province of goods from beyond the borders of the Union.

(*k*) Receipts of a miscellaneous nature connected with matters entrusted to the Province.

APPENDIX II.

Correspondence with the Provincial Governments regarding Readjustments within the Meston Settlement.

LETTER FROM THE GOVERNMENT OF INDIA, TO ALL PROVINCIAL GOVERNMENTS, F. No. 116 (V) F./26, DATED SIMLA, THE 13TH AUGUST 1926.

SUBJECT :—*Report of the Indian Taxation Enquiry Committee in its relations to the Meston Settlement.*

I am directed to address you on the subject of the distribution of taxes between the Central Government and the Provincial Governments, which has been discussed by the Indian Taxation Enquiry Committee in Chapter XVI of their Report. In paragraph 6 of their Resolution No. 1412-F., dated the 26th May 1924, announcing the terms of reference to the Committee, the Government of India stated that it would be no part of the duties of the Committee to consider the equity of the Meston Award, and that they should merely indicate the theoretically correct distribution of taxes between Imperial, Provincial and Local. The Committee have traced the principles underlying the systems of federal taxation in other countries and specified the taxes which, in their opinion, should appropriately be allocated to the Imperial or the Provincial Governments, as the case may be, and also those which might be regarded as affording possible balancing factors for establishing financial equilibrium in giving effect to any scheme of redistribution. They consider that a division of the income-tax is unavoidable, if the distribution of the taxes is to be fair to industrial and agricultural provinces alike, and that, if equilibrium can be secured by this means alone, it is undesirable to use any other balancing factors. Their final recommendations reduce themselves to :—

(*a*) the transfer of non-judicial stamps, excise duty on country made 'foreign' liquor and possibly the revenue now derived from excise opium to the Imperial Government, and

(*b*) the establishment of equilibrium by the transfer to the provinces of a share of the income-tax.

2. The Government of India recognised clearly at the very outset that any reform in the taxation system would inevitably involve at least a partial revision of the Meston Settlement, but it was obviously undesirable to include within the scope of the Committee's enquiry a highly controversial problem the ultimate solution of which, whatever the theoretical merits of any particular scheme, could only rest, in the absence of intervention by higher authority, upon an agreement acceptable to the Government of India and the Provincial Governments. I am now to indicate the provisional views of the Government of India on the subject, which should be regarded as purely tentative and intended merely to facilitate discussion. It is proposed to discuss the matter at the Conference of Financial Representatives to be held in November next, by which time, it is hoped, the Provincial Governments will have come to some more or less definite conclusions.

3. I am to make it quite clear at the very begining that, in considering the application of any scheme of division of taxes, the Government of India propose to take as their starting point the financial position of the provinces as it will be when all the provincial contributions have been extinguished. No departure from the undertaking, which has been repeated on more than one occasion, to wipe out these contributions as early as possible, is or will be contemplated. Indeed, any other course would lay the Government of India open to the accusation of trying to benefit one province at the expense of another.

4. In seeking a new scheme of distribution, I am to state that the Government of India consider that practical considerations and the requirements of equity demands the recognition of certain basic factors and principles, which are indicated below :—

(1) The Meston Award should be regarded as the settlement which holds the field so far as its major achievements are concerned.

(2) The changes to be introduced into that Settlement should be kept down to the minimum.

(3) Any sacrifice of revenue involved in a redistribution of taxes must be at the expense of the Central Government and can not be made until the provincial contributions have ceased.

(4) The distribution of taxes should give the Central Government sufficient freedom to expand its revenues to meet emergencies, such as a great war.

I am also to impress on the Provincial Governments in this connection that it is an essential feature of the reformed constitution that the duty of finding additional resources for the financing of progressive policies rests on the Provincial Governments and their Legislatures, and that, when once the improved settlement now under discussion has come into existence, they will be expected, whenever necessary, to make use of their existing powers of taxation and to develop the possibilities of elasticity contained in them, and, in particular, to find a way out of some of their special difficulties by developing municipal taxation and expenditure.

5. I am now to discuss the specific recommendations of the Indian Taxation Enquiry Committee with reference to the general principles enunciated above. The proposal of the Committee that the revenue from excise opium should be transferred to the Imperial Government has already been rejected by the Government of India for reasons which have been explained in Mr. Tottenham's letter C. No. 43-E. O./26, Finance Department (Central Revenues), dated the 30th June 1926. Similar administrative objections apply to the recommendation of the Committee to transfer the excise duty on country made 'foreign' liquor to the Central Government. The Government of India have not yet arrived at a definite decision on the question, but so far as the present reference is concerned, they do not propose to take this recommendation into consideration.

6. The proposal of the Committee, to centralise non-judicial stamps, with which I am next to deal is, in the opinion of the Government of India sound. As the Committee have pointed out, the authors of the Report on Indian Constitutional Reforms intended that the revenue from general stamps should be allocated to the Central Government. It was diverted to the provincial exchequer by the Meston Committee because, to quote the words in paragraph 312 of the Taxation Enquiry Committee's Report," that Committee found no other means of securing a complete separation of the sources of revenue between the Provincial and the Central Governments which would give an adequate revenue to certain provinces." The Joint Select Committee of the Houses of Parliament which considered the Meston Committee's Report, while they departed so far from the principle of separation of sources as to recommend that the provinces should be granted a share in the growth of revenue from taxation of incomes, made no suggestion as to the restoration of general stamps to the Central Government. The reasons justifying such a retransfer have been elaborated in paragraphs 314-316 of the Taxation Committee's Report. To avoid some of the inconveniences of the present system, the Government of India have already been compelled to reserve the right of fixing the duty on some of the more important items in the Stamp Schedule Moreover, such important problems as the extension and improvement of banking and money market facilities, with which they have to deal, are closely bound up with questions of stamp duty. The Government of India, therefore, are inclined to accept the recommendation of the Committee that non-judicial stamps should be transferred from the provinces to the Central Government.

7. To compensate the provinces for the loss of revenue from non-judicial stamps, the Committee have recommended that they should be given the proceeds of a basic rate on personal incomes graduated proportionately to the general rate. The Government of India recognise, that, in order to give additional elasticity to provincial revenues, it is desirable to give the provinces a share of the income-tax, and they agree with the Committee that the personal incomes from all sources of assessees resident within the province would reflect the progress in well-being of its inhabitants so far as any income-tax statistics can reflect them and would, therefore, be an equitable basis for the division of the income-tax. They consider, however, that the adoption of a graduated rate would be inconvenient from the point of view of both the Central Government and the Provincial Governments, since it would create difficulties in the event of a decision to alter the rates or to adopt a new system of graduation. They would, therefore, prefer a flat rate on personal assessable incomes to the formula suggested by the Committee. This arrangement would replace the present arrangement under Devolution Rule 15. I am to enclose a table showing on the basis of estimated figures (which would require to be modified on the basis of actuals to be hereafter obtained) the approximate amounts of the assignments for each province in respect of incometax proceeds if this formula

were adopted and the amount to be distributed in the first year were fixed respectively at 3 crores and 3½ crores.

8. It is obvious that, whatever scheme for the division of the income-tax is adopted, it will be impossible exactly to balance the loss of revenue from non-judicial stamps of each of the provinces. I am to state that, in the opinion of the Government of India, the only solution by which financial equilibrium can be established and which can give satisfactory results is to make up deficiencies by means of a method of fixed assignments to each province from the central revenues. They prefer this to a system of contribution from provinces since any system under which a provincial Government would raise taxes locally to finance central expenditure is undesirable and is open to the objection that it distributes the burden of taxation unfairly. They recognise that there are corresponding objections to a system of central contributions, but these are, in their opinion, less weighty both in theory and practice. The assignments from the Central Government will be so fixed as to place each of the provinces in approximately the same financial position at the outset as if no change had been made in the Meston Settlement. I am to add that, in connection with any revision of the Meston Settlement on the lines indicated above, the Government of India propose to abolish any existing annual assignments which are recurrent and are of the nature of compensation paid to or by a province in consideration of the minor modifications already made in the Meston Settlement. Examples of such assignments are those made in respect of customs duty on Government stores, those made on account of unified stamps, and those under Devolution Rule 15. All these will be merged in the final figure for each province.

9. To sum up, the proposals which are now under the consideration of the Government of India and on which I am to invite the opinions of Provincial Governments are briefly as follows :—

(1) Non-judicial stamps will be transferred to the Central Government.

(2) The provinces will be given the proceeds of a flat rate of income-tax (say, for purposes of illustration, 2½ or 3 pies in the rupee) on personal assessable incomes from all sources (including dividends from companies wherever situated) of assessees resident within the province. The administration of the income-tax department will continue to be exclusively under the Central Government, but it is not proposed to debit any portion of the cost of the department to the Provincial Governments.

(3) The resulting provincial deficits, adjusted with reference to existing annual assignments, will be made good by means of fixed assignments from the Central Government which will remain unchanged indefinitely, the amounts of such assignments being so calculated as to place the provinces in approximately the same financial position at the outset as if no change had been made in the Meston Settlement. The flat rate of income-tax will be so

fixed as to reduce the Central assignments to as low a figure as possible.

I am to emphasise that this scheme is put forward not as a definite proposal of the Government of India but only as a tentative plan which they have under consideration.

10. In conclusion, I am to state that the Government of India will be obliged if they may have the considered views of the Government of

before the 1st October 1926 so that they may be ready with definite proposals for discussion at the Conference of Financial Representatives in November next.

Enclosure to letter No. F.-116 (V) F./26, dated the 13th August 1926.

Provinces.	Personal S. T. income *plus* Personal I. T. income Estimated average of 3 years (1922-23-24-25).	Assignments in lakhs on a 3 crore basis, *i.e.*, 2·6 pies per rupee.	Assignments in lakhs on a 3½ crore basis (3·03 pies per rupee).
Madras	27,18,58,500	36·84	42·98
Bombay ..	69,17,78,696	93 72	109·34
Bengal	50,89,78,152	68·97	80·46
United Provinces..	15,42,16,880	20·88	24·36
Punjab	16,41,00,900	22·23	25·93
Burma	19,18,45,100	25·98	30·31
Bihar and Orissa	10,22,90,617	13·86	16·17
Central Provinces	8,97,70,550	12·15	14·17
Assam	3,96,46,666	5·37	6·26
Total ..	2,21,44,86,061	300·00	350·00

LETTER FROM THE GOVERNMENT OF ASSAM, No. 6506-F. M., DATED THE 30TH SEPTEMBER 1926.

I am directed to refer to your letter No. 116 (V) F.-26 of 13th August 1926, and to say that the Governor in Council has carefully considered the tentative scheme there put forward for the revision of the Meston Settlement. He observes that while it is intended to place the provinces in approximately the same financial position at the outset as if no change had been made in the Meston Settlement, the actual effect is to substitute to a considerable extent a fixed assignment for expanding sources of revenue. This arrangement must be peculiarly unfavourable to a province like Assam which is now largely undeveloped but is in process of steady and continuous development, necessarily involving a growing expenditure from public funds, and the Governor in Council trusts that special consideration will be given to the peculiar conditions of this province before any change is made in the existing system.

2. The revenue which Assam derives from non-judicial stamps, is, as will be seen from the figures noted below, growing steadily and fairly rapidly. Part of the increase is due to the increased rates of stamp duty temporarily levied for three years under the Assam Stamp Act, 1922, and continued for a further period of three years by the Assam Stamp Act, 1925; but apart from the effects of those Acts there is a steady and substantial increase which was only checked in

1921-22 by the non-co-operation movement. It is certain that with the development of the province the rate of increase in this source of revenue will be accelerated; and that the present proceeds from represent but a small proportion of what the proceeds will be in a few year's time. The province, therefore, stands to lose heavily by the substitution for its revenue from non-judicial stamps of an assignment fixed on the basis of the present receipts.

Net receipts.	Stamps, non-judicial
1919-20	4,64,053
1920-21	4,82,498
1921-22	4,11,866
1922-23	5,35,597
1923-24	6,28,134
1924-25	6,91,492
1925-26	8,05,972

3. In part compensation for the loss of this fruitful and promising resource, it is proposed to assign the proceeds of a flat rate of income-tax on personal assessable incomes, which would take the place of the provincial allocation provided for by Devolution Rule 15. By this rearrangement also the Assam Government would stand to lose substantially. As was pointed in paragraph 3 of Mr. Lloyd's letter No. 5530-F. M., dated the 18th July 1925, Assam benefits in a peculiar degree by the present arrangement since the profits of tea companies were first assessed to income-tax after the year 1920-21, but this addition to the provincial resources is only equitable, since the existence of the great tea industry in Assam, necessitates heavy expenditure in almost every branch of the provincial administration. In the absence of reliable figures relating to dividends from tea companies assessed to income-tax outside the province but paid to persons resident within the province, it is not possible to say precisely what the provincial loss would be under the proposed arrangement, but the Governor in Council is assured that it would be considerable and that the estimated figures given in the statement appended to your letter are considerably higher than would actually be reached. The preponderance in Assam of tea companies working on sterling capital renders the proportion of the dividends distributed to residents within the province much smaller than in the case of most other provincial industries, and any empirical calculations relating to this matter based on conditions prevailing in India generally must operate to the detriment of Assam.

4. In paragraph 4 of your letter, the Government of India impress upon Provincial Governments that the duty of finding additional resources for the financing of progressive policies rests upon them and that when the new settlement now under discussion has come into existence, they will be expected, whenever necessary to make use of their existing powers of taxation and to develop the possibilities of elasticity contained in them. The difficulty of inducing the Legislative Council to agree to any such course of action is not peculiar to Assam but, in respect of the exploitation of taxable resources, Assam labours under special difficulties to which I am to invite the attention

of the Government of India. The Government of Assam have more than once protested against the continuance of the export duty on tea, not merely on abstract economic grounds, but also because its levy prevents any adequate contribution being taken from the tea industry to meet the cost of the provincial administration, which as already explained is greatly increased by the existence of the industry within the province. Import duties, which are entirely central, constitute another serious burden upon the industry, while under the proposed arrangement, stamp duties will be centralised and the present small share of the income-tax allocated to the local Government will be considerably reduced. In these circumstances one important potential taxable source is deprived of all elasticity which could be exploited for provincial purposes, while elasticity under other heads is not easy to find. A gradual reduction of the Excise revenue seems inevitable, and apart from Forests, the development of which must depend to a large extent on capital expenditure and will be a slow process, Land Revenue will under the proposed arrangement be the only important head of expending revenue left to the local Government. There are however limits to the amount which can be taken from the ordinary cultivator and it would be obviously unfair to make that class pay for the increased cost of the administration due to the existence of a special industry, which is already fully exploited for the purposes of central taxation.

5. For these reasons the Governor in Council views the scheme set forth in your letter with the gravest misgivings. He cannot but feel that the substitution for growing sources of revenue of a fixed assignment which will remain unchanged indefinitely will render it impossible to provide adequately for the needs of the province during its present stage of development; and he trusts that in the course of the discussions which are to take place on this subject, some more equitable solution will be found.

LETTER FROM THE GOVERNMENT OF THE CENTRAL PROVINCES, No. C.-95/1483-X, DATED THE 3RD OCTOBER 1926.

I am directed to reply to your letter F. No. 116 (V) F./26, dated the 13th August 1926, on the subject of the distribution of taxes between the Central and Provincial Governments, with special reference to the recommendations made by the Indian Taxation Enquiry Committee in chapter 16 of their report. The scheme tentatively outlined is based on the condition precedent that the present provincial contributions have already been extinguished and it is then proposed that the Head non-judicial stamps should be transferred to Central Revenues and that in its place the provinces should be given the proceeds of a flat rate on the income-tax on personal assessable incomes from all sources; the resulting provincial deficits being made good by means of fixed assignments from the Central Government. The assignments are to remain unchanged indefinitely and to be so calculated as to place the provinces in approximately the same financial position at the outset

as if no change had been made in the Meston Settlement.

2. The Governor in Council, in considering the financial and other effects of these proposals, has for the reasons outlined below experienced considerable difficulty in coming to any definite conclusions. In the statement appended to this letter the revenues derived during each of the last 5 years from these two heads are given. Both are expanding sources of revenue, but owing to changes which have occurred in recent years, both in regard to the methods of assessment in the case of Income-Tax and the rates of assessment in the case of both taxes, it is difficult to determine finally under which head there are greater potentialities of growth. The recent reorganisation of the Income-Tax department led to an immediate increase in the estimate of assessable income, but in the last two years there has, it will be seen, been an important drop of over Rs. 90 lakhs below the figures of 1923-24. The present net revenue from non-judicial stamps is about Rs. 19¼ lakhs, and at the present rates the normal annual growth of revenue appears to be about Rs. 50,000. On the other hand, the provincial share of Income-Tax will, according to the flat rate sanctioned by the Government of India, be between Rs. 12 and Rs. 14 lakhs, and if, despite the present slump, the normal annual increase in personal assessable income be taken at Rs. 27 lakhs (*vide* statement), the normal growth in the provincial share of the revenue under this head will vary from Rs. 35,000 to Rs. 42,000 according to the flat rate sanctioned. So far, therefore, as the figures have value they show that in recent years there has been a great natural growth and expanse in the revenue derived from non-judicial stamps than in that from personal Income-Tax.

3. It is also probable that, in a province situated like the Central Provinces with its predominant agricultural interests these conditions may continue to prevail almost indefinitely. Business, commerce and industries have only a subordinate importance and the sources of Income-Tax are therefore limited, while the profits from stamps come alike from transactions connected with land, as well as from other business. In addition, the chief industries of the provinces, its coal and manganese mines and its cotton mills, are all largely in the hands of companies, the shareholders of which are mainly not resident within the province. The Governor in Council, therefore, inclines to the view that the province is not likely to profit financially by the proposals now outlined, as if the present ratio growth of the two taxes continue, the methods proposed in paragraph 9 (3) of your letter under reply for adjusting the resulting provincial deficits will operate increasingly to the financial disadvantage of the province.

4. The local Government will also have no control over the alterations of assessment in regard to both taxes, a factor which would directly affect the rate of expansion. At the same time it will render itself dependent on a tax which is universally unpopular and the enhancement of which will always be resisted, as against a tax which is only indirectly felt by the whole community and which,

as the recent Stamp Amendment Act, no longer in force, has shown, is capable of considerable enhancement should local circumstances require that this be done.

5. Whatever therefore may be the theoretical advantages of the scheme proposed, there are practical objections which have considerable weight, and in so far as the purely local interests of the province are concerned, the Governor in Council inclines to the view that the maintenance of the existing settlement *minus* the provincial contribution, would be more advantageous to it than the scheme proposed. In any case before he commits himself in regard to the present proposals of the Government of India, he desires to have some idea of what the intention of the Government of India is in regard to the proposals of the Taxation Committee in respect of the future rates of assessment of these two taxes.

STATEMENT.

I. Statement showing the gross and net revenue from non-judicial stamps realised during the years 1921-22 to 1925-26.

(The figures are in thousands.)

Year.	Total revenue.	Total expenditure	Net revenue.	Increase or decrease of revenue as compared with the previous year.
	Rs	Rs.	Rs.	Rs.
1921 22 ..	17 23	1,09	16.14	..
1922 23 ..	19.28	1,14	18,14	+2,00
*1923 24 ..	22,70	1,80	20,90	+2,76
1924 25 .	24.28	1,32	22,96	+2,06
1925-26 ..	24,16	1,58	22,58	—0,38
†1926-27 ..	21,09	1,83	19,26	—3,34

* Year during which the enhanced rates prescribed by the C P Stamp Amendments Act were in force.

† Budget figures.

If the net revenues of the years 1921 22 and the budgetted net revenues of 1926-27 be compared, during which years the same rates were in force, there is an increase of Rs. 3·12 over 6 years, or an annual growth of Rs. 0·52.

II. Statement showing the assessed personal income on which income-tax revenue is calculated for the years 1921-22 to 1925-27.

Year.	Amount of Assessed Income.	Increase or decrease on the figures of the previous year.
	Rs.	Rs.
1921-22	6,19,76	..
1922-23	7,23,01	+ 1,03,25
1923-24	8,47,76	+1,24,75
1924-25	7,77,19	—71,57
1925-26	7,56,91	—19,28

If the assessable income of 1921-22 be compared with that of 1925-26, there is an increase of Rs. 1,37·15 over 5 years or an annual growth of Rs. 27·43. This would yield to the Province from

Rs. 35,000 to Rs. 42,000 increase according as the Flat Rate selected is 2½ or 3 pies.

LETTER FROM THE GOVERNMENT OF MADRAS, No. 24262-ACCTS.-1, DATED THE 2ND OCTOBER 1926.

Report of the Indian Taxation Enquiry Committee in its relations to the Meston Settlement—Ref. Letter from the Government of India, Finance Department, F. No. 116 (V) F./26, dated 13th August 1926.

In reply to the letter from the Government of India referred to above, I am directed to state that, if the Madras Government understand them aright, the proposals of the Government of India accept the position which this Government have always maintained, namely, that no question of revision of what is known as the Meston Settlement can arise until this Government are secured in all their revenues under that scheme, that is to say, those revenues of which they would be possessed, if and when the provincial contributions have been extinguished. They entirely concur that, once that has been effected, the proposal of the Indian Taxation Enquiry Committee to centralise non-judicial stamps is sound.

2. As regards the arrangement under which Provincial Governments are to be compensated for the loss of provincial revenue to which this reform will give rise, I am to say that the tentative conclusion of this Government is that the proposals of the Government of India are probably as equitable as could be devised. I am to add, however, that, in their opinion, the flat rate should be so adjusted that, at the outset, no province shall receive more than approximately the amount of revenue actually lost by the transfer of general stamps. It seems clear that, if the flat rate were pitched sufficiently high, some provinces might receive under this head alone considerably more than the revenue thus lost.

3. The Madras Government recognize that these proposals substitute for general stamps a source of revenue which may prove much more progressive in some provinces than in others, as a percentage increase in the sum total of the personal assessable income in one province will give a much larger additional revenue than a similar percentage increase in another. That result, however, seems to them to be equitable, and they trust that the proposals of the Government of India will result in an adjustment of the financial settlement which will not only meet the position of this Government but prove acceptable to other provinces which have attached much greater importance to the right of sharing in the proceeds of the income-tax.

LETTER FROM THE GOVERNMENT OF THE UNITED PROVINCES, No. B.-848, DATED THE 7TH OCTOBER 1926.

I am directed to invite a reference to Mr. Jukes' letter No. 116 (V) F./26, dated August 13, 1926, which deals with the recommendations of the Indian Taxation Inquiry Committee on the subject of the distribution of taxes between the Central and

Provincial Governments. In this letter, the Government of India ask for the opinion of the Local Government on the proposals :—

(*a*) to transfer non-judicial stamps to the Central Government ; and

(*b*) to reimburse provincial revenues by means of the proceeds of a flat rate of income-tax on personal incomes from all sources, with a fixed and permanent assignment in adjustment of any deficit.

2. As regards the first proposal, the Governor in Council has no observation to make save that he agrees entirely with the arguments by which the Taxation Inquiry Committee support the suggestion to retransfer general stamp revenue from the provincial to the central exchequer.

3. The Governor in Council, however, is not satisfied that the second proposal, which he has carefully considered, is equally acceptable, and offers for the consideration of the Government of India the following criticisms.

4. (*a*) The Government of India, in paragraph 7 of Mr. Jukes' letter, recognize "that in order to give additional elasticity to provincial revenues, it is desirable to give the province a share of the income-tax." This share of income-tax will be based on the assessable income, and the revenue derived therefrom will expand as that income expands. In other words the provincial share of the income-tax revenue will be capable of natural growth. But the revenue derived from general stamps is also capable of natural growth, as the actual receipts of recent years prove. If the exchange of one source of revenue for the other, is to be fair, then clearly the province should receive a sufficient share of income-tax revenue to produce the entire sum which it now receives from the general stamp duties ; and the proposal to substitute a fixed assignment for a part of that revenue will not satisfy that condition, because it has the effect of depriving the province of a part of that natural growth of revenue generally by which it at present benefits. And this loss will be appreciable. The revenue derived from general stamps at present is approximately 36 lakhs ; a flat rate of 3·03 pies per rupee would produce a little over 24 lakhs , so that the fixed assignment on this basis would be 12 lakhs. One-third of the new source of revenue would, therefore, be entirely incapable of natural growth.

5. (*b*) Though the revenue derived from general stamps is on the whole progressive, and has actually increased at the average rate of a lakh per annum during recent years ,yet in the same period not only has the income assessed to income-tax declined, but the number of assessees has fallen. The Governor in Council suggests indeed that for the reasons noted below the growth of income, and consequently of income-tax revenue, will always lag behind the growth of income-tax revenue derived from general stamps.

(1) The causes which produce variations in these two types of tax are much the same ; the revenues from both tends to increase in prosperous times and to decrease in times of depression. But in the case of general stamp revenue, the variations due

to these causes are less marked than in the case of income-tax revenue. General stamp duties for the most part relate to transactions involving, directly or indirectly, some transfer of property. In prosperous times, the number of these transactions increases because there is more property coming into the market in the course of trade or commerce. But in times of depression, though the amount of money seeking investment in property decreases, yet the number of transfers does not necessarily decrease proportionately, since credit operations of all kinds are required to tide over the period of depression.

(2) Moreover in so far as the growth of income-tax revenue and the growth of general stamp revenue are due solely to increased prosperity, the former growth will always, for two reasons,—one natural and one artificial—be slower than the latter. The natural reason is that the increased number of transfers of property which causes the growth of revenue from general stamps, must have time before they can produce their natural effect in the growth of income, and consequently of income-tax revenue. The artificial cause is that income-tax is always assessed on the income of the preceding year. The Governor in Council suggests that, as a general rule, a prosperous trade year would produce an increase in the revenue from general stamps in that year, but would not increase the income-tax revenue till the next year, or the next year but one.

6. This tendency of income-tax revenue to lag behind general stamp revenue is of special importance in the circumstances of the province. The province already benefits by a steady growth in its general stamp duties. If it is to give up that revenue and receive in lieu a share of its income-tax revenue, it will not obtain an equal benefit immediately though it may do so in course of time. But in the present financial position of the province, it is the present that matters; the future, bringing with it further remissions of the contribution, will not be so difficult from the financial point of view.

7. (*c*) As has been mentioned above, the normal annual growth of general stamp revenue averages a lakh of rupees. To obtain the same result from the share of income-tax (even if the average rate was fixed sufficiently high to dispense with the need for any adjusting assignment), the growth of assessable income would have to be 62 lakhs per annum. Judging from past results, the Governor in Council has little hope that such an increase will occur in the near future.

8. (*d*) The Government of India suggest that the share of income-tax which they propose to give to the province in lieu of general stamp revenue will give additional elasticity to the provincial revenues. The term "elasticity" as applied to taxation usually connotes that its proceeds can be artificially expanded or contracted by varying the rate of taxation. That is true of the existing revenue from general stamps; but it will not be true of the proposed share of income-tax, since presumably the Government of India will retain the right to vary the rates of income-tax. In the opinion of the Governor in Council, therefore, the proposal, so far from increasing, will actually decrease the elasticity of provincial revenues.

9. The Governor in Council, therefore, considers that the proposed change will prove disadvantageous to the province and, unless some means can be devised to avoid the consequent loss, he is not at present prepared to support it.

LETTER FROM THE GOVERNMENT OF BENGAL, No. 1453-T.—F. B., DATED DARJEELING, THE 2ND OCTOBER 1926.

[*Report of the Indian Taxation Enquiry Committee in its relation to the Meston Settlement.*]

I am directed to refer to your letter No. F. 116 (V) F.-26, dated the 13th August 1926, on the above subject, in which the Government of India, acting on the recommendations of the Indian Taxation Enquiry Committee as to the theoretically correct distribution of the proceeds of taxation as between Imperial and Provincial, and in particular on the specific recommendation that a division of the income tax is unavoidable if the distribution of the taxes is to be fair to industrial and agricutural provinces, propose a modification of the Meston Settlement.

2. *In limine* I am to say that the Governor in Council welcomes this fresh opportunity of being able to urge his contentions against the injustice to Bengal of the Meston Settlement and the necessity for a thorough revision. In paragraph 17 of letter No. 720-F., dated the 19th January 1925, from this Government, which contained a representation for a continuation of the remission of the provincial contribution, His Excellency in Council observed that this remission could do no more than merely postpone the general revision of the whole Meston Settlement in at least so far as this Government was concerned. It is true that in their present letter the Government of India propose a revision, but on the face of it it would appear that the revision which they contemplate is merely of an internal character, and would by no means be a solution of the difficulties of this province. It will be shown later how the proposed solution is not to the benefit of Bengal but the reverse, even so far as it goes; but the Governor in Council is compelled to dissent from the general basic principles which the Government of India put forward in paragraph 4 of their letter under reply as a precedent to the consideration of the solution they tentatively suggest, and he must record his emphatic protest against them. In formulating these principles the Government of India state that in considering the application of any division of taxes they propose to take as their starting point the financial position of the provinces as it will be when all the provincial contributions have been extinguished, and that it is a basic factor and principle that the Meston Settlement should be regarded as the settlement which holds the field as far as its major achievements are concerned, and that the changes to be introduced into that settlement should be kept down to the minimum. Their intention seems to be that the settlement, as eventully determined, should be made so as to leave the provinces with revenues in amount as determined by the results of the Meston Settlement, without the liability for any contribution to the Central Government. This Government have,

however, always maintained, even apart from the remission which has been secured, that injustice has been done to Bengal and that that injustice will remain even when all the provincial contributions have been extinguished. As compared with other provinces, Bengal may have secured some advantage by the temporary remission of its contribution, but that advantage will disappear and the province will be in a worse position when all the contributions have ceased.

3. The Government of Bengal have throughout the long correspondence on the subject of this settlement asserted, firstly, that the award was based on an abnormally low figure for expenditure and not on a reasonable estimate (if indeed the expenditure was at all taken into account), secondly, that it did not provide a working surplus—an obligation recognised by the Meston award—and, thirdly, that it did not give Bengal an expanding revenue to cope with the growing needs of the province. The prognostications of this Government as regards the first and second points were completely justified, for the immediate effect of the award was a very considerable deficit as was indeed admitted by the Government of India. This Government had to impose additional taxation, resort to drastic measures of retrenchment and to ask for the remission of the provincial contribution. The finances of the province are somewhat better, but even now there is no working surplus and there is not a sufficiently expanding revenue. The local Government, thanks to additional taxation and the remission of the provincial contribution, is solvent, but they can do nothing of value to cope with the growing needs of the province.

4. The main contention of this Government is whatever may be the manner in which the proceeds of taxation be allotted for the needs of Bengal, that allocation will never be satisfactory unless and until the total proceeds bear a sufficient approximation to the expenditure of the province. By the Meston Settlement Bengal was placed in a position of very considerable deficit—the expenditure far exceeded the revenue—with the remission of the provincial contribution that deficit was reduced but by no means wiped out. It seems scarcely necessary again to enlarge on the facts, they have been so often pressed on the Central Government and are well known to the Government of India. The financial plight of Bengal has been admitted, and it has been recognised by the temporary remission of its contribution. The remarks of Sir Malcolm Hailey, quoted in paragraph 5 of this Government letter No. 720-F. of the 19th January 1925, may be here repeated :—

> "We have examined the case both narrowly and critically and it appears certain that with every economy Bengal must have a deficit of not less than Rs. 120 lakhs, even if we make no allowance for any extra expenditure on improvements in transferred subjects, such as are desired by Ministers—improvements which we are told are necessary if the system of Reforms is to be a success. Bengal would have that deficit even if it

provided only the bare minimum expenditure required to carry on the ordinary administration of the province.

5. The temporary remission of the contribution has been of some assistance to the local Government, but the Governor in Council desires to repeat that the Government of Bengal accepted this under protest as a mere palliative, and that he cannot accept it as a final solution of the question. The complaint of the Government of Bengal has always been that sufficient regard was not had to the expenditure of the province. The Meston Settlement did not give sufficient regard to the fact, that, when the financial changes consequent on the Reforms were under consideration, Bengal was working merely on a provisional settlement. That provisional settlement had been made in 1912 for a period of three years only and its revision had to be postponed owing to considerations arising out of the war, and had not been effected when the Reforms came under consideration. Had that revision been effected, there cnnot be the slightest doubt—and this is supported by the investigations made preparatory to the appointment of the Meston Committee and subsequently on the representations of this Government against the Meston award—that an inevitable increase must have been made in the revenues of the province in order to meet its expenditure. An inevitable consequence of this would have been therefore that the increased spending power of Bengal under the new distribution of revenues recommended by the Meston Committee, as found by that committee would have very largely disappeared and the premises on which the Meston Committee based its recommendations would have been materially altered. The local Government must therefore press again for a thorough revision of the whole settlement.

6. Adverting however to the proposals which the Government of India put forward for the transfer of the revenue from non-judicial stamps from the Provincial Governments to the Central Government, and its replacement in the revenues of the Provincial Governments by a share of the receipts from income tax and a fixed assignment to make up for the resulting provincial deficit, there is undoubted force in the arguments that have been put forward on various occasions, reiterated recently by the Taxation Enquiry Committee, that non-judicial stamps should be a central source of revenue. It is recognised that their allocation to provincial revenues was primarily based on the fact that by no other means then found feasible was it possible, following the underlying principle that there should be complete separation of sources of revenue between the Central and Provincial Governments, to secure to certain provinces adequate revenues. This Government need therefore not object, provided it is assured of another source (or sources) of revenue, at least equally satisfactory and equally capable of the same financial possibilities.

7. In the opinion, however, of the Governor in Council the proposals of the Government of India—a share in the income tax *plus* a fixed

assignment—entirely fail to meet this condition; and he is compelled, therefore, to say that he is unable to accept them as a satisfactory arrangement. In paragraph 7 of their letter under reply the Government of India remark—"The Government of India recognise that in order to give additional elasticity to provincial revenues it is desirable to give the provinces a share of the income tax." The Government of Bengal find it, however, impossible to understand how the proposals of the Government of India will make for additional elasticity. The proposal is to replace non-judicial stamps, an elastic source of revenue, by an elastic source of revenue, income tax, producing a fractional part (in Bengal, on the higher estimate, only two-thirds) of the revenue derived from non-judicial stamps with the deficit made up by a fixed assignment. The Government of Bengal have not access to the figures on which the share of the receipts to be given to the local Government has been based, but those figures which they have do not exhibit that capacity for expansion which is possessed by non-judicial stamp revenue. It is therefore not clear to what extent that source of revenue—income tax—is at present elastic. However that may be, elasticity is in part to be replaced by inelasticity; it is diminished instead of being added to, and Bengal undoubtedly would lose rather than benefit from the proposal.

8. The facts relative to the non-judicial stamp revenue in Bengal make this abundantly clear. The normal standard taken at the time of the fixation of the present settlement was Rs. 84,60,000. In order to clear its recurring deficit and secure equilibrium in its finances, but solely as a temporary measure for this purpose, the local Government with the assent of the Legislative Council increased the rates of non-judicial stamps and secured a very considerable enhancement of its revenues. The full effect of this measure has not yet been obtained, but nevertheless in the past year the revenue from this source amounted to Rs. 1,30,59,000. The Governor in Council must, and the Legislative Council in particular would, object most strongly to the replacement of this source of revenue which has shown itself so capable of expansion by a new arrangement, which would be in part a fixed assignment and for the remainder a source producing a lesser revenue and with no greater comparative power of expansion. That objection has all the more force inasmuch as the increased taxation, although temporarily meant to produce equilibrium, was eventually intended for development in the more popular side of the administration. It follows that the local Government cannot agree to any proposal for a change in the present allocation of revenue unless that change produces equal, if not greater, elasticity in the sources of revenue made available to the province. The local legislature would equally strongly object to a measure which would place at the disposal of the Central Government the increased revenue, which by their own legislation they have secured with the intention of carrying out the development of their own province, for what on the face of it is a less elastic source of revenue. If no other solution can be devised the Governor in

Council considers that the existing arrangement by which non-judicial stamps are retained by the province may well be allowed to continue. Although there are difficulties in dealing with that source of revenue, as it relates to subjects administered by the Government of India, these difficulties have been got over in the past and there has been no particular inconvenience.

9. The Governor in Council, however, recognises that it is but fair that the provinces, particularly industrial provinces, should have a share in the income tax. This is all the more necessary in Bengal which differs from all the other provinces of India, except Bihar and Orissa, in that its Land Revenue is based on a permanent settlement, is partacularly inelastic in nature, and on the basis of population compares very unfavourably with other provinces. It has indeed already been admitted that the provinces should have a share of the profits on industrial and commercial undertakings, but by the Meston Award the Government of Bengal have been deprived of such profits by the Government of India retaining the income tax while leaving it to the Government of Bengal to maintain entirely the administration, at a great expense, of a city which has grown to the size and importance of the City of Calcutta by reason of its large industrial and commercial undertakings.

10. While, however, the Governor in Council would agree with the proposal that in any modification of the present settlement the provincial Governments should have a share of the income tax, he is not satisfied, even apart from the conclusions set out above, that the proposals put forward in paragraph 7 of the Government of India letter constitute the best method of giving effect to this intention. With the suggestion of a flat rate he agrees: it is the simplest method, it gives a feeling of some elasticity, it provides for expansion and it is an encouragement to a local Government to develop its industries. The difficulty which the Governor in Council sees has reference to the basis of assessment. The proposal is to give the proceeds of a flat rate on personal assessabe incomes from all sources of assessees residen within the province. The idea underlying this is that the income tax is primarily a personal tax and that the provinces cannot equitably claim anything in the shape of a tax from persons not resident in their jurisdiction. It is not clear, however, whether in referring to personal assessable incomes and a flat rate thereon, the Government of India propose to impose this flat rate also on personal incomes assessed to the super tax—although from the statement appended to their letter personal super tax incomes are included. The Taxation Enquiry Committee, while recommending a share in the income tax for the provinces, expressed the opinion that super tax should go to the Central Government. The Government of India make no allusion to this recommendation; and I am, therefore, to request that their intentions in this respect may be expressed more clearly and that the expression "personal assessable income" may be defined.

11. Nor do the Government of India make any reference to the further recommendation of the Taxation Enquiry Committee that in addition to the allotment made on personal incomes, the allocation of which is based entirely on domicile, there should be partial recognition of the principle of origin by assigning to each province a small portion of the receipts of the corporation profits tax, by which term they designate the tax on the profits of companies now known as the super tax, and in respect of which they have made certain suggestions including the renewal of the present exemption limit. The Governor in Council maintains that it is in the income of companies and undertakings of this kind that the commercial prosperity of a province is reflected and that the considerations, which justify the allocation to an industrial province of at least a share in the income tax from persons, are of no less weight in the case of the tax derived from companies. The test of domicile may be of greater weight and value than that of origin; nevertheless the distinction may well be obliterated when the provinces are to receive only a share of the receipts from income tax. The Governor in Council urges therefore that instead of resorting to the complications of personal assessable incomes and corporation profits, the solution lies in a flat rate based on the total of all assessable incomes.

12. In paragraph 8 of their letter the Government of India explain how the difference between the flat rate on the income tax and the revenue from non-judicial stamps is to be made up. In their opinion, the only solution which can give satisfactory results is to make up deficiencies by means of a method of fixed assignment to each province from the central revenues. As has been shown, the result would not be satisfactory—the provinces would largely lose the possibility of expanding revenue which they might obtain if they retained non-judicial stamps. Part of an elastic source of revenue would be exchanged for an inelastic assignment. Their further suggestion for the merging of existing annual assignments in the final figure merely, in the opinion of the Governor in Council, adds to the unsatisfactory nature of the arrangement. Taking one instance, the Government of Bengal receive an assignment now of Rs. 11,30,000 on account of unified stamps, with a possibility of an increase after the term of five years for which the settlement of this assignment is made. The Government of Bengal will lose any such increase by the merging of this assignment in the proposed fixed assignment. The Governor in Council must, therefore, strongly object to the proposal for a fixed assignment, if it is intended to cover a deficiency caused by a change in the allocation of revenues which has the effect of depriving this province of revenues capable and possible of expansion and increase.

13. The proposals which the Government of India put forward in a tentative fashion do not, therefore, commend themselves to this Government; and His Excellency in Council is compelled to reiterate the statement that the Government of Bengal cannot be satisfied unless at any rate they are secured sources of revenue no less elastic than

the present and providing sufficient expansion to meet at least the ordinary growth of expenditure.

14. In this connection I am to bring to the notice of the Government of India the fact that it has been pressed upon the local Government from time to time that Bengal should be given a share of the export duty on jute. The Governor in Council has generally met this contention by holding out that whilst he cannot remain satisfied with the Meston Settlement, he would leave it to the Imperial Government in the first instance to consider by what means a revision can satisfactorily be made. It is observed, however, that the Taxation Enquiry Committee have included export duties in the list of possible balancing factors in connection with the distribution between Imperial and Provincial; and His Excellency in Council, therefore, urges that in a revision of the settlement part at any rate of the proceeds of this duty may be credited to this province. The share of the exports of jute belonging to Bengal would amount to approximately 90 per cent of the total export; and a share of the export duty on this article can, therefore, fitly be credited to Bengal without causing any complications in the settlement *vis-à-vis* other provinces.

LETTER FROM THE GOVERNMENT OF THE PUNJAB, No. 29613-B., DATED THE 11TH OCTOBER 1926.

I am directed to reply to your letter F. No. 116 (V) F./26, dated the 13th of August, 1926, regarding the report of the Indian Taxation Enquiry Committee in its relations to the Meston Settlement. I am to communicate the provisional views of the Governor in Council and to explain that they are intended to facilitate discussion and are not to be regarded as committing this Government to any decision.

2. In regard to the basic factors and principles enunciated in paragraph 4 of your letter, I am to say that the Governor in Council accepts them on the understanding that they do not refer to any changes that may be made in the Meston Settlement as a result of the enquiry of the Statutory Commission to be appointed under section 84-A of the Government of India Act. He assumes that this is the intention of the Government of India.

3. In regard to the financial aspect of the specific proposals contained in your letter, I am, in the first place, to observe that the receipts from non-judicial stamps in this province include certain fees and taxes imposed other than under the Stamp Act, which are collected in the form of non-judicial stamps for administrative convenience. It is assumed that your proposals do not extend to fees of this kind, but are confined to receipts from non-judicial stamps collected as duty imposed under the provisions of the India Stamp Act of 1899 and the connected provincial amendment Acts. On this assumption, the change proposed involves (*a*) the surrender by provincial Governments of the power to increase or reduce the rates of stamp duty on certain transactions, which they now exercise with the sanction of the Governor-General, (*b*) the surrender by provincial Governments to the Central Government of receipts from

non-judicial stamps, and (c) the grant by the Central Government of compensation equivalent to the receipts of non-judicial stamps as calculated at the time of surrender, the compensation consisting of :—

(i) the proceeds of a flat rate of income-tax, and

(ii) a fixed cash assignment representing the difference between the amount surrendered and the initial proceeds of the flat rate of income-tax.

I am to say that the Governor in Council considers that, purely on financial grounds, the proposals are open to two objections: In the first place, they deprive provincial Governments of valuable means of raising new taxation or of giving relief in existing taxation, and they thus curtail the flexibility of provincial finance. In the second place, they involve the partial substitution of a source of revenue which contains the element of natural increase by a fixed assignment, and they are, therefore, unfavourable to those provinces in which the natural increase in the initial proceeds of the flat rate of income-tax will not suffice to cover the natural increase in the revenue from non-judicial stamps. In this province, it is estimated that the natural increase in receipts from income-tax and in receipts from non-judicial stamps is at the same rate, which may, for the purpose of illustration, be assumed to be 5 *per cent.* per annum. The present receipts from non-judicial stamps are on the average about 40 lakhs per annum, while the proceeds from flat of 3·03 pies per rupee of income assessed to income-tax would be 26 lakhs. On this basis, the fixed cash assignment made by the Government of India would be 14 lakhs, and the Punjab Government would lose by the transaction the equivalent of compound interest on this sum at 5 *per cent.* per annum.

4. I am, however, to state that the Governor in Council is opposed to the proposed changes less on account of considerations of financial gain or loss to individual provinces, than because they offend against general principles to which he attaches importance. He considers it to be essential to the development of self-Government that the distribution of resources and powers between the Central and Provincial Governments should be such as to give to the latter sufficient powers in regard to the enhancement and reduction of taxation as will enable them to hold the balance fairly between different classes of the community. In his view it is not sufficient that local Governments should enjoy a share of the proceeds of taxation imposed by the Government of India on the industrial and commercial classes; local Governments must have the power to determine within reasonable limits the burden of taxation that these classes shall bear. The necessity of this power is especially felt in provinces such as the Punjab, where agricultural interests predominate and where political developments are in the direction of the creation of rural and urban parties, which in many matters tend to follow communal sympathies. The recent fiscal policy of the province has, to a considerable extent, been determined by the necessity of reconciling the conflicting interests of these two parties; and the fact that it

has been possible to make substantial increases in the revenues of the province without serious opposition is largely due to the exercise by Government of its powers of taxation in such a way as to distribute the additional burden over all classes. The rural classes submitted less unwillingly to an increase in the canal rates because simultaneous measures were taken to enhance the stamp duty on transactions that primarily affected the urban population. In the same way it is now possible so to arrange reductions of taxation as to benefit all classes. The Governor in Council regards with apprehension a state of affairs in which it would not be possible for this Government either to tax or to relieve the section of the urban community which is composed of the industrial and commercial classes, but such a position would be created if the change now proposed were accepted. He is confident that the change would be viewed by the majority of members of the Punjab Legislative Council with disapproval, that it would embarrass Government in its fiscal policy, and that it would accentuate class and communal bitterness by a serious curtailment of the present powers of the local Government to reconcile divergent interests

5 I am to say that the Governor in Council would attach less importance to the considerations mentioned in the last paragraph were it possible, as the Government of India suggest, to find a way out of provincial difficulties by the development of local taxation. I am to explain that, as the local Government has not the legal power to compel local bodies to impose additional taxation. it cannot redress inequalities in provincial taxation as between different sections of the community by enforcing what it considers to be suitable standard of local taxation. It is no doubt possible in theory to secure the desired result by differentiation between various local bodies in the amount of financial assistance given by Government; but, while indirect pressure of this kind may be, and is now used to induce a particular municipal committee or district board to raise a specific tax to the general pitch, it cannot be used as between urban and rural bodies without aggravating the class and communal feeling which it is the policy of Government to mitigate.

In connection with the general question of local taxation, I am to observe that the reformed constitution, which has, in effect, transferred the administration of beneficient departments on behalf of Government to ministers and their supporters in the Council, necessarily encourages a progressive increase in expenditure from provincial sources on those activities, *e.g.*, Education, Medical and Veterinary relief and communications, which may be regarded as a joint charge on provincial revenues and local funds. The total expenditure on these services tends steadily to increase while the proportion of the total provided by local bodies tends steadily to fall. In the opinion of the Governor in Council this tendency will persist since, apart from the natural desire of the Legislative Council to provide liberally for the beneficient departments, it is now generally recognised that it is only by means of a large measure of provincial finance and provincial control that it is possible,

firstly, to avoid serious deterioration in efficiency, and, secondly, to secure a uniform standard of development throughout the province.

While, therefore, the Governor in Council accepts the desirability of the expansion of local resources, he considers that their development at the expense of provincial revenues would be inimical to progress, and that practical difficulties will so restrict their independent development as to afford little relief to provincial responsibilities.

6. In conclusion, I am to say that the Governor in Council considers that any change that may be made in the scheme of distribution of resources should satisfy two essential conditions; firstly, that it should not curtail but should, if possible, extend the existing powers of provincial Governments to tax urban interests; and secondly, it should not involve the substitution of a fixed assignment for a source of revenue which contains the element of natural growth. Subject to the above conditions, the Governor in Council will be glad to consider any scheme which will have the additional advantage of removing from the sphere of provincial taxation matters which are to some extent of all-India concern.

LETTER FROM THE GOVERNMENT OF BIHAR AND ORISSA, No. 3585-F. R., DATED THE 27TH OCTOBER 1926.

In reply to Mr. Jukes' letter No. F. 116 (V) F.—26, dated the 13th August 1926, I am directed to say that on the general administrative ground that the rates of duty imposed by means of non-judicial stamps should be uniform throughout India, the Governor in Council is prepared to accept the recommendation of the Indian Taxation Enquiry Committee that the administration of non-judicial stamps and the revenue derived from them should be transferred from the provinces to the Central Government.

2. In exchange for the revenue that will be lost to the provinces if effect is given to this proposal, the Government of India propose to apportion to them :—

(*a*) the proceeds of a flat rate on personal incomes assessable under the Income Tax Act, and

(*b*) a fixed assignment equal to the difference between the proceeds of the flat rate and the revenue from non-judicial stamps which will be diverted to the Central Government.

His Excellency in Council is prepared to accept the proposition that the loss to provincial revenues on account of the transfer of the revenue from non-judicial stamps should be made good by the assignment of a further share of income-tax, but he considers that the method of making the adjustment outlined by the Government of India in the letter under reply is open in several respects to doubt and objection.

3. In the first place the local Government are unable to discover how the figure of Rs. 10,22,90,617 shown in the enclosure to the letter as the estimated average of the personal I. T. income *plus*

the personal I. T. income in Bihar and Orissa for the 3 years 1922-23, 1923-24 and 1924-25 has been arrived at. The corresponding figure supplied by the provincial Commissioner of Income-tax is only Rs. 8,53,06,667. The Government of India state in paragraph 9 of their letter that it is their intention that the flat rate should be so fixed as to reduce the fixed assignments to as low a figure as possible. The revenue from non-judicial stamps in Bihar and Orissa may be taken as roughly Rs. 20 lakhs a year. If either of the rates given in the enclosure to the letter is adopted, the fixed assignment necessary to make up the deficiency will be considerable. If either of those rates is applied to a total of assessed incomes amounting to only just over Rs. 8½ crores, the deficiency to be made good by the fixed assignment will be larger still. The local Government would therefore press that, if the system of 'expansible' *plus* fixed assignment is to be adopted, the 'expansible' assignment should be so calculated—if necessary at a separate rate for each province—as to reduce the fixed assignment to the lowest possible limits.

4 The local Government understand that the average of the 3 years 1922-23, 1923-24 and 1924-25 is given in the enclosure to the letter under reply solely by way of illustration, and that it is the intention that the 'expansible' assignment should be recalculated every year on the assessed incomes of the last year but two. But the rate of the 'expansible' assignment is apparently to be fixed at least for a term of years and the amount of the fixed assignment is to be determined once and for all It therefore makes a considerable difference which year or series of years is taken as the basis of these calculations, and it is essential that the period taken should be a normal one.

5. The Government of India propose to give the 'expansible' assignment in the form of a flat rate on the total of incomes assessed to income-tax *plus* those assessed to super-tax, so as to allow for the varying distribution of tax-payers in the different grades in the different provinces. They prefer this system to the graduated rate proposed by the Committee on the ground that in the latter case difficulties would arise in the event of a decision to alter the rates or to adopt a new system of graduation. The local Government are not clear how the graduated rate proposed by the Committee would operate, but they consider that the expressed intention of the Government of India of giving additional elasticity to provincial revenues would be more effectively attained by the assignment of an extra share of the tax collected than by the suggested flat rate. No administrative difficulty would be involved in the system, and the local Government would derive some benefit from an increase of rates or from a relative increase in the number of tax-payers in the higher grades, of which the flat rate on assessed incomes would deprive them.

6. I am also to draw attention to the fact that if personal incomes only are taken as the basis of the calculation to the exclusion of the incomes of companies, the Government of Bihar and Orissa will be prejudicially affected in comparison with other provinces. As the Government of India are aware, there are a number of joint stock

companies engaged in exploiting the natural resources of this province on a large scale, which are registered, and the majority of the shareholders of which reside, outside the province. If the local Government are given no share in the revenue derived from the assessment of these companies they will be deprived of what the natural resources of the province and the progress in well-being of its inhabitants would reasonably entitle them to expect.

7. The conclusion of the local Government on the proposal of the Government of India, is, therefore, that they have no general objection to the transfer of the revenue from non-judicial stamps to the Central Government if the difference is made good by the transfer of an extra share of the income-tax. As to the exact form of the adjustment, they consider—

(*i*) that the expansible assignment should be as large and the fixed assignment as small as possible, even if this involves the fixing of a different rate for each province, and that care should be taken to ensure that the calculations are based on normal and not on abnormal years.

(*ii*) that the expansible assignment should take the shape of an extra share of the tax collected and not a flat rate on assessable incomes; and

(*iii*) that the calculation of the expansible assignment on the basis of personal incomes is inequitable in the peculiar circumstances of Bihar and Orissa, and that some arrangement should be made whereby the provincial revenues may derive some benefit from the profits of companies operating within the province. This should not be difficult to arrange if the assistance to be given to the province takes the form of an additional share of the tax collected.

8. Finally, I am to say that the Governor in Council views with some anxiety the position in which Bihar and Orissa is likely to be placed relative to other provinces when the temporary benefits conferred by the Meston Settlement have lapsed. In paragraph 18 of the Meston Committee's report it is admitted that "in Bihar and Orissa the local Government is quite the poorest in India and very special skill will be required in developing its resources". It is true that the provincial surpluses of the last few years appear to give the lie to these misgivings, but these surpluses have been almost entirely due on the one hand to severe economy and the starvation of essential services, and on the other to the expansion of the Excise revenue. This head, to which the province is indebted for 2 out of its 5½ crores of revenue has now, it is generally admitted, reached its high water mark, and there are in any case objections to exploiting it further. Land Revenue has practically reached its limit. The increase of court fees means taxing litigation, and is always open to attack. The Government forests are small. Irrigation is not a profitable head in Bihar and Orissa, and never will be. Registration and the remaining revenue heads are of minor importance. There is

therefore every justification for the statement of the Meston Committee (paragraph 18) that "there is a wholly abornmal want of elasticity about its (*i.e.*, this province's) revenues". That the Reforms would entail a greatly increased expenditure on the part of Government has always been recognised (*i.e.*, in paragraph 256 of the Montagu-Chelmsford Report), and in paragraph 4 of their letter under reply the Government of India impress upon the local Governments that it is an essential feature of the Reformed constitution that the duty of finding additional resources rests upon them. But, for the reasons stated above, little more can be expected from the existing revenue heads, while the more readily expansible sources of revenue such as salt, income-tax and customs, are not available. The province is naturally rich in minerals and, if further provincial taxation is to be raised, these are the obvious subjects of taxation. When however, the local Government proposed to impose a tax on coal and coke, the Government of India refused to sanction the introduction of the Bill in their letter No. 463-F., dated the 6th March 1923. When the Meston Settlement lapse and Bihar and Orissa falls into line with the other provinces as contemplated by the Government of India, it will have to bear unrelieved the burden of its own lack of wealth. When that occurs some provinces, including Bihar and Orissa, cannot fail to be left behind by their more fortunate rivals in the process of development, and the ultimate result may well be that the less fortunate provinces will be driven into an attitude of administrative revolt, accompanied by an acute development of provincial patriotism. Such a state of affairs cannot be conducive to the good of India as a whole. The provinces are not naturally divided sub-nations, but fortuitously composed of administrative units, and none more conspicuously so than Bihar and Orissa. In the opinion of His Excellency in Council the tendency to reduce finance to terms of isolated provincial units facing one detached central administration is one that should be discouraged. If the provinces are to remain parts of a single whole with a strong Central Government at the head, the stronger provinces must be prepared to help the weaker, and although the principles on which their financial settlements are made may be the same, His Excellency in Council is strongly of opinion that their application to individual provinces must take some account of individual needs.

LETTER FROM THE GOVERNMENT OF BOMBAY, NO. 5029-A., DATED THE 26TH OCTOBER 1926.

With reference to the Honourable Mr. Jukes' letter F. No. 116 (V) F.-26, dated 13th August 1926, I am directed by the Government of Bombay to express their regret and disappointment that the principles enunciated in the letter ignore the continually repeated protests of the Bombay Government against the inequity of the Meston Settlement. It would not be convenient nor indeed is it necessary to repeat in this letter the arguments on which those protests were based. They are well known to the Government of India, and the Government of Bombay can only repeat its desire that the

Settlement should be submitted to the judgment of an impartial tribunal. The Settlement was based on assumptions which are in a number of instances false, and on anticipations, which have not been realised. The Muddiman Committee recommended a reconsideration of the Settlement, and the Government of India themselves recognised in their reference to the Taxation Enquiry Committee that Devolution rule 15 had failed entirely to achieve its ostensible purpose. Yet the present proposals of the Government of India intend "to place each of the provinces in approximately the same financial position at the outset as if no change had been made in the Meston Settlement".

2. On the other hand the Government of Bombay has been led to suppose that the Government of India sympathizes with the claims of the industrial provinces to a larger share in the revenues derived from industries than the Meston Settlement has given, and it may be that the principle as defined is not to be taken *au pied de la lettre*, and that the revision now in contemplation will take into consideration what those provinces have lost and are losing owing to the defects of the Devolution rule 15.

3. The point of view of the Government of India is understood to be this, that whatever the merits of the case the Meston Settlement has now been so long in force that the provincial standards of expenditure have become crystallized and that it is impracticable to ask the provinces to reduce those standards. Any rectification of inequalities in the Settlement must therefore be made at the expense of the Central Revenues and not at the expense of other Provinces. Had the protests of this Government been listened to, it would not be possible to make use of this argument now; but in any case the argument cannot validly be employed in giving preference to further relief (in the shape of further remission of their contributions) to other Provinces at the expense of an industrial province which has admittedly been deprived of a just share of its industrial revenue. The high standards of living and the consequent cost of the administration in Bombay are themselves the result of previous financial arrangements made by the Government of India, and the province has the right to expect to be able to maintain those standards with the help of a reasonably expending revenue.

4. That Devolution rule 15 has worked in a thoroughly unsatisfactory manner and has failed to give relief to those provinces which it was primarily intended to benefit is admitted on all sides and needs no elaboration. Any revision of the Settlement which is based on Devolution rule 15 as it stands, will perpetuate the hardship to the industrial provinces which this rule was specifically designed to alleviate. This Government therefore claims that before any revision of the Settlement is undertaken Devolution rule 15 should for purposes of the revision be modified and the revision should then take into account what this province would have got under the rule as so modified. The Government of Bombay desire that a modification of Devolution rule 15 on the lines already suggested by them should be taken in hand at once

and that such revision should have precedence of any further remission of provincial contributions if the finances of the Government of India do not permit of the introduction forthwith of the revised settlement.

5. The suggestion to which I refer was put forward at the last conference of Financial Representatives and was to the effect that a revised datum line should be based on the ten pre-reform years ending with 1920-21. Most of the objections made by the Taxation Enquiry Committee are obviated under this datum line. This Government would further urge that the difference between what they would have received under the proposed Devolution rule and what they have actually received since the Reforms should be made up to them by a lump payment at the time of revising the Settlement.

6. Coming to the proposed transfer of non-judicial stamps to the Central Government, while agreeing that there are certain items in the schedule to the Stamp Act relating to commercial transactions in which centralisation is desirable, the Government of Bombay are not prepared to admit that the centralisation of all non-judicial stamps is necessary either for administrative convenience or in the interests of commerce and banking. It is not possible in this letter to deal with this question in detail, and I am instructed now to say only that this Government desire to reserve their final opinion as to the need for complete transfer of all non-judicial stamps. If it is found after examination desirable to leave with provincial administrations certain items, the actual details must be settled later between the Government of India and the Provincial Governments. The question is likely to give rise to difficult legal and technical questions, such as the need for separate provincial stamps, which would require careful consideration. It will be difficult to estimate with any degree of accuracy the amount of revenue accruing from the items which a Provincial government will surrender.

7. The accompanying statement, No. II, will show that non-judicial stamps is an important and steadily growing source of revenue in this Presidency. Another very important consideration is that a local Government has at present the power to vary the rates by legislation. They will lose this power in the case of all non-judicial stamps that are centralised. There are certain items in the stamp schedule, (*e.g.*, contract notes by a broker or agent and transfers) which are sources of considerable potential revenue to this Government. For such items as they do surrender they should be compensated in such manner as to make up not only for their existing revenues but for their prospective expansion.

8. As regards the method by which the share of the taxation of income is to be distributed among the different provinces, the letter from the Government of India does not explain how the figures in the enclosure to the letter are arrived at. It would appear that the method is based, in the absence of accurate figures, on a number of assumptions, and it is understood that actual figures are

being collected. I am to attach a statement (No. I) which compares what this Government would get at 2·6 pies and 3·03 pies in the rupee on total personal income tax income *plus* personal supertax income with what it would surrender under non-judicial stamps and under Devolution Rule 15. The figure of the total personal income-tax income *plus* personal supertax income, 69·18 crores, is that worked out by the Central Board of Revenue for Bombay and given in the enclosure to the Honourable Mr. Jukes' letter. The figure, 62·46 crores, is the average of the total assessed income of this Presidency for the three years 1922-23 to 1924-25. The receipts under Devolution Rule 15 are at 3 pies in the rupee on the total assessed income. If therefore the pie rate adopted is such that $\frac{69}{62}$ of it is equal to 3 the increments under Devolution Rule 15 will be equal to those at that pie rate on the total of the personal income-tax income *plus* personal supertax income If the pie rate adopted is such that $\frac{69}{62}$ of it is less than 3 the receipts under Devolution Rule 15 at the various stages would be larger than those under the pie rate, and *vice versa*. But neither the proportion between the total income tax income *plus* the total supertax income and the total assessed income, nor the pie rate, are fixed quantities.

The figures are merely illustrative. It is not known what the actual proportion will be for the year which is finally adopted for the purpose of the settlement, nor at what pie rate it will work out. It will be seen that even at the 3·03 pie rate this Government does not get a "share of revenue which expands in proportion to the growth in prosperity and the taxable capacity of the province as evidenced by its personal assessed income".

It may be noted in connection with Statement No. I that it assumes the revenue from non-judicial stamps to be fixed although it is a steadily expanding source, and is also worked out on the basis of the present unsatisfactory Devolution Rule 15 and not on the revised rule proposed by this Government. Figures of what would be received at higher pie rates than 3·03 have been worked out, but they all show that the receipts fail to expand adequately with the increase in assessed personal incomes. It is likely therefore that this basis of personal income-tax income *plus* personal supertax income may have to be abandoned. It is however impossible for the Government of Bombay to commit themselves to any definite opinion without knowing the actual figures of personal income-tax income and personal supertax income. They are advised that it is not a matter of very great difficulty to obtain actual figures from the various provinces and they would therefore prefer to await them before expressing any further opinion as regards this method In order to obtain the desired elasticity the Government of Bombay would submit that two other methods are available. The method proposed by the Taxation Enquiry Committee was that of graduating the basic rate proportionately to the general rate. They do not consider that, there are any insuperable difficulties in the way of such graduation. It is not impossible to adopt such a graduated rate for the different classes of income for which separate statistics may be maintained and to adhere to it, what-

over alterations in the rates may be subsequently made by the Government of India for their own purposes. The second method is that of giving a higher pie rate to the industrial provinces in which a larger proportion of the income-tax is derived from incomes assessed at the higher rates than in the agricultural provinces.

9. Paragraph 8 of the Honourable Mr. Jukes' letter deals with the question of fixed assignments to the provinces. It may be pointed out that the total revenue from non-judicial stamps for the whole of India is 486 lakhs for the year 1924-25 while the pie rates have been worked out on the assumption that the sum available for distribution will be 3 crores or 3½ crores. As no provincial Government will care to surrender a growing source of revenue for revenue a substantial portion of which would be in the shape of fixed assignment, it is absolutely essential that the pie rate should be kept as large as possible and the fixed assignment as small as possible, or entirely eliminated.

10. Before concluding, the Government of Bombay desire once again to bring the acute financial condition of this province to the notice of the Government of India. The financial position has been reviewed by the Accountant General in the section II-D of his Appropriation Report for the year 1924-25. On that the Auditor General has commented as follows :—" The inability of the Bombay Government since 1923-24 to meet the whole of its statutory obligations under the Devolution Rules from its ordinary net revenues as shown in paragraphs 17—19 of the Report, the additional liabilities on the revenues in connection with Civil Works expenditure not costing more than 5 lakhs in each case, taken over from 1926-27, the growth of interest and sinking fund charges in respect of borrowings on capital account and the other very heavy commitments mentioned in paragraphs 34 and 36 of the Report, combined to show that the financial position in the near future will be serious. It is doubtful whether even the remission of the contribution to the Central Government will be sufficient in itself to ease the situation". This Presidency is now faced with the prospect of very heavy recurring deficits. It has levied additional taxation to the extent of Rs. 90 lakhs since the Reforms, besides raising revenue under Excise and other heads, to about the same extent by means of executive action. It is the opinion of the Legislative Council, which is shared by the non-official European members, that the limit of taxable capacity in the province has been reached. No progress in the nation building departments handed over to the Ministers under the Reforms is possible in the absence of the necessary funds. This Presidency is thus faced with the prospect of stagnation, while other more fortunate provinces are reducing taxation. If the proposals of this Government regarding the modification in Devolution Rule in paragraph 5 cannot be accepted and brought into force from the next financial year, it is urged that the provincial contribution of this Presidency may be temporarily remitted as in the case of Bengal, since its financial condition is very much worse than that of that province.

11. The position of this Government may be summed up as follows :—

(i) The Government of Bombay maintains its claim that the Meston Settlement should be reconsidered.

Subject to this claim,

(ii) the Government of Bombay desire Devolution Rule 15 to be modified as suggested, before the proposed revision of the Settlement is effected and the revenue which Bombay would receive from the Devoluton Rule 15 as so modified to be taken into account in considering it share of the taxation of income.

(iii) The difference between what Bombay would have received under a more equitable Devolution Rule 15 and the existing rule, since the Reforms, should be made good by a lump payment to Bombay

(iv) The modification of Devolution Rule 15 should take precedence of the remission of provincial contributions if both cannot be effected at once.

(v) Further detailed consideration should be given to the question of dividing non-judicial stamps between Central and Provincial Governments.

(vi) The proposed basis for distributing their share of the income-tax among the different provinces cannot be accepted in the absence of reliable figures. The basis should be determined after obtaining actual figures of personal assessed incomes of the different provinces and should be such as to compensate adequately provinces such as Bombay which derive a larger share of the tax from income assessed at higher rates than other provinces.

(vii) The pie rate on the assessed income should be as high as possible and the fixed assignments as low as possible, or eliminated.

(viii) The rate should be so fixed as to compensate the provinces for the prospective growth of revenue from the non-judicial stamps and for the loss of the right to increase it by means of provincial legislation.

(ix) If immediate relief cannot be given to this Presidency by means of the modifications in the Devolution Rule 15 proposed in (ii) and (iii), its provincial contribution should be remitted temporarily.

12. In conclusion, I am to put forward for the consideration of the Government of India that in the event of these proposals failing to secure acceptance, it will be more equitable in any case that the India surplus in 1927-28 should be divided in arithmetical proportion to the amount of the outstanding contributions instead of according to the existing scale.

STATEMENT I.

BOMBAY.

Forecast showing the difference between share at 2·6 pies and 3·03 pies per rupee on total personal income-tax income *plus* personal super-tax income and receipts under non-judicial stamps and under Devolution Rule 15.

Personal income-tax income and personal super-tax income (assumed).	Share at 2·6 pies per rupee on column 1.	Share at 3·03 pies per rupee on column 1.	Receipts from non-judicial stamps (assumed).	Receipts* under Devolution Rule 15 (assumed).	Total of columns 4 and 5.	Difference between columns 2 and 6.	Difference between columns 3 and 6.
1	2	3	4	5	6	7	8
Crores.	Lakhs.	Lakhs.	Lakhs.	Lakhs.	Lakhs.	Lakhs.	Lakhs.
Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
69·18†	93·7	109·3	94·6†	5·2†	99·8	—6·1	9·5
70	94·8	110·5	110		110	—15·2	0·5
75	101·6	118·4	110	3·1	113·1	—11·5	5·3
80	108·3	126·3	110	10·1	120 1	—11·8	6·2
85	115·1	134·2	110	17·2	127·2	—12·1	7·0
90	121·8	142·0	110	24·2	134·2	—12·4	7·8

* Figures in this column are worked out on the basis of the average for the three years 192-2-23, 1923-24 and 1924-25 when the average total assessed income was 62 46 crores. For the same period the figures in column 1 given by the Government of India is 69 18 crores. Figures on this proportion have been worked out in this Forecast for future years and receipts under Devolution Rule 15 calculated.

† Average for 3 years 1922-23, 1923-24 and 1924-25

STATEMENT II.

The following statement shows the revenue from non-judicial stamps in Bombay Presidency and Sind from 1905-06 onwards :—

	Years	Lakhs of Rs.
	1905-06	29·4
	1906-07	28·6
	1907-08	28·9
	1908-09	28·2
	1909-10	31·1
	1910-11	34·8
	1911-12	34·8
	1912-13	39·2
	1913-14	40·3
	1914-15	34·8
War period	1915-16	37·5
Rise in prices and speculation ..	1916-17	46·6
	1917-18	54·7
	1918-19	64·2
	1919-20	94·3
Land Speculation and industrial boom.	1920-21	101·5
	1921-22	84·3
Amendment of Stamp Act ..	1922-23	94·9
	1923-24	91·2
Increase of assignment on account of unified stamps from 3·3 lakhs to 12 5 lakhs.	1924-25	97·9
	1925-26 (Revised).	95·5
Tax on Transfers of Property in Bombay.	1926-27 Budget).	111·1

LETTER FROM THE SECRETARY TO THE GOVERNMENT OF BURMA, FINANCE AND REVENUE DEPARTMENT, No. 179-N.-26, DATED RANGOON, THE 8TH NOVEMBER 1926.

SUBJECT :—*Report of the Indian Taxation Committee in its relation to the Meston Settlement.*

I am directed to submit the views of the Local Government on the proposals which are summarised in paragraph 9 of your letter F. No. 116 (V) F./26 of the 13th August 1926 for the modification of the Meston Settlement. These proposals are that receipts from non-judicial stamps should be transferred to the Central Government and that in order to compensate them for the resulting loss of revenue Provincial Governments should receive the proceeds of a flat rate of income-tax on personal assessable incomes from all sources of assessees resident in the Province together with a fixed annual assignment so calculated as to place each Province in approximately the same financial position at the outset of the revised arrangements as if no change had been made in the Meston Settlement. Existing annual assignments on account of unified stamps and those under Devolution Rule 15 on account of income-tax would disappear.

2. These proposals do not commend themselves to His Excellency in Council. They are unlikely to produce in the case of Burma the additional elasticity in the Provincial revenue which is desired by the Government of India. It is *prima facie* improbable that the Local Government would benefit by the substitution of an assignment, based on the personal incomes of residents of the Province and supplemented by a fixed assignment, for the receipts from a growing source of revenue like non-judicial stamps, supplemented by an elastic assignment based on the excess of the assessed income of the year over the assessed income of 1920-21. Receipts from non-judicial stamps in Burma have of recent years shown a very satisfactory annual growth and the rate of expansion is likely to continue. It is open to the Local Government to increase its revenues from this source by careful administration and by raising the rates of stamp duty. Burma is primarily an agricultural country and a large share of the receipts from non-judicial stamps comes from the agricultural population. The general stamp revenue is benefited alike by the prosperity and the misfortunes of the agriculturists. Prosperity encourages the purchase of land; misfortunes necessitate its sale and mortgage. A vigilant District Officer can secure an appreciable increase in the general stamp revenue of his district by encouraging his subordinates to be watchful for evasions of the Stamp Law. It is right that the Provincial revenues should depend as largely as possible on the efficiency of the Provincial Administration. It is wrong to substitute for any portion of these revenues receipts which depend on the administration of a Central subject with which the Local Government has nothing to do.

3. Non-judicial stamps were made a Provincial subject on the recommendation of the Committee on Financial Relations who "found no other means of securing a complete separation of the

sources of revenue between the Provincial and Central Governments which would give an adequate revenue to certain Provinces." That Committee was "not disposed to see grave disadvantage in different rates of stamp duty in different Provinces, at least on some of the transactions for which duty has to be paid;" it remarked that "any uniformity which may be decided to be essential can always be secured by Central legislation", and it pointed out that "general and Judicial stamps are controlled by the same agency, and there is a good deal of miscellaneous work and outlay common to both." The disadvantages of the present arrangement as set out in paragraph 314 of the Report of the Indian Taxation Enquiry Committee are :—

(1) "inconvenience in cases where an instrument stamped in a Province in which the stamp duty has not been increased is sought to be exhibited in another Province where it has been increased", etc.,

(2) the fact that several Provinces "lose a substantial portion of their legitimate revenue under this head as a result of provincialisation," as for example, in the case of the stamp duty on cheques and on share transfers. So far as Burma is concerned these disadvantages are theoretical rather than practical, and in any case they can be removed by Central legislation. His Excellency in Council would not object to a proposal that receipts from stamp duties prescribed by Central legislation and collected by means of unified stamps should be credited to Central revenues and that the resulting loss to Provincial revenues should be made good, not by an enhancement of the fixed assignment on account of unified stamps now received from the Government of India, but by an increase in the present assignment on account of the growth in incomes assessed to income-tax.

4. The Government of India propose that the Provinces should receive the proceeds of a flat rate of income-tax on personal assessable incomes from all sources of assessees resident within the Province. It is presumed that if the Government of India were at any future time to raise the present limit of non-assessable incomes they would duly compensate Local Governments for the resulting loss to Provincial revenues. The personal incomes of the residents of a Province no doubt reflect the progress of those residents in well-being so far as any income-tax statistics can reflect them; but a better basis for calculation would be the whole of the assessed incomes, whatever the sources, which are earned in the Province. In Burma trade other than petty trade is nearly all in the hands of British firms whose headquarters lie outside the Province and of Indians whose Senior Partners live in other Provinces of India and the personal income of those resident in the Province forms a comparatively small part of the total income which is earned within the Province. An insignificant fraction of the shares of the Burma Oil Company, Limited, the Burma Corporation,

Limited, the Bombay-Burma Trading Corporation, Limited and other large payers of income-tax is held by income-tax payers resident in Burma. The banking business of the country outside the large towns is practically monopolised by the Natukottai chetties from the Madras Presidency. Most of the capital employed in their business consists of profits earned in Burma but only a minor part of the chetties' income from Burma is assessed in this Province. The principals of the money lending firms reside in the Madras Presidency or in the Indian State of Pudukotta, and their personal income, where assessed to income-tax, is assessed in the Presidency. A large proportion of the rice trade of the Province is in the hands of Gujerati-speaking Indians from the Bombay Presidency; many of these are assessed to income tax in Bombay. A considerable portion of the Import Trade is in the hands of the same class of Indians, and practically all the partners of these importing firms have their permanent residence in the Bombay Presidency or in Kathiawar. Their fortunes have been amassed in Burma but the Province receives no credit from the income-tax which they pay.

5. The Government of India propose to make good the difference between the receipts from the flat rate of income-tax and the receipts from non-judicial stamps by a fixed assignment from Central to Provincial. Fixed assignments are objectionable in principal, especially when they are large, and it is inevitable that the amount of the assignment will be appreciable in the case of some Provinces. In the enclosure to your letter it is estimated that taking the average for the three years 1922-1925, personal incomes assessed to income-tax and Super tax in Burma, amounted to over Rs. 19 crores. The Governor in Council is not in a position to check this estimate but he believes that when actual figures have been obtained it will be found to be on the high side. On the assumption that the Government of India propose to adopt the same basic rate for all Provinces the Local Government is satisfied that Burma's share of the income-tax will require to be supplemented by a very large fixed assignment in order to make up for the loss of the receipts from non-judicial stamps. The necessity for a fixed assignment would disappear if the flat rate for calculating the income-tax were varied from Province to Province. In the opinion of His Excellency in Council it is no more objectionable to vary the rate than to vary the amount of the fixed assignment.

6. In paragraph 4 of your letter the Government of India remarked that "practical considerations and the requirements of equity" demand *inter alia* that the changes to be introduced in the Meston Award should be kept down to the minimum. The Local Government agrees that this condition is essential but it does not think that it should be held to preclude a modification of the Award necessitated by the correction of an error in the figures on which the Award was based. In the case of Burma, the Land Revenue receipts of the Province wrongly included the revenue from the Capitation Tax and the Land-rate in lieu thereof which are levied in Lower Burma and the Thathameda-tax which is levied in Upper Burma. The Indian Taxation Enquiry Committee

has accepted the view of this Government (which has on more than one occasion been placed before the Government of India and which was also placed before the Meston Committee when it visited the Province) that these taxes should be converted into sources of local revenue and excluded from the Provincial Budget. A full statement of the case in respect of these taxes was placed before the Government of India in my letter regarding the resolution adopted by the Burma Legislative Council during the Session of September 1925 that the Export duty on rice and the Excise duty on petrol and kerosene oil should be made over to the Local Government in order *inter alia* to allow the Local Government to give effect to this recommendation of the Taxation Enquiry Committee. The Government of India have rejected the specific request made in my letter that the receipts from these sources of revenue should be assigned to the Local Government but I am to express the hope that they will see fit to take some other measure to rectify the wrong.

EXTRACT FROM THE PROCEEDINGS OF THE CONFERENCE OF FINANCIAL REPRESENTATIVES, 1926.

First Meeting.

Recommendations of the Indian Taxation Enquiry Committee in relation to the Meston Settlement.

The Chairman explained the scheme outlined in the letter of the Government of India on the modification of the Meston Settlement and referred to the principal points raised by the local Governments in their replies.

The proposals briefly were :—

(*a*) to transfer non-judicial stamps to the Central Government,

(*b*) to re-imburse provincial revenues by means of the proceeds of a flat rate of income-tax on personal incomes from all sources, with a fixed assignment in adjustment of any deficit.

The main objections of the provincial Governments to the scheme were that it meant the substitution of fixed assignments for a portion of the proceeds of stamp duties which constituted a growing source of provincial revenue and that it would remove from the control of provincial Governments an important sphere of taxation. In order to meet these difficulties he had suggested a division of non-judicial stamps under which only documents which were of a commercial or quasi-commercial character would be transferred to the Central Government, while the provinces would retain conveyances, mortgages, leases and other important revenue-yielding items. Bihar and Orissa desired that the provincial assignment should take the shape of a share of the Income-tax collected, but there are obvious objections to this proposal. For instance, if the Government of India were to reduce the rates of income-tax a loss of revenue would thereby be inflicted on provincial Governments; while, on the other hand, if the Government of India decided to raise the rates owing to a war or some other emergency, the provincial Governments would gain additional revenue without regard to actual requirements.

The original intention was to apply the pie rate to the total personal assessable incomes *plus* personal super-tax incomes, but further examination of the question led to the conclusion that it would be preferable to base the assignment on personal incomes only.

* * * * * *

After discussion it was decided to constitute a Sub-Committee to consider the following points :—

(1) whether the suggested division of stamp duties between the Central Government and the Provincial Governments (see Appendix I) was appropriate ;

(2) whether it was possible to estimate the yield of the stamp duties to be centralised ;

(3) whether the difficulties of allocating the companies' tax among the different provinces according to origin and domicile could be overcome ; and

(4) whether a uniform pie rate would be preferable to a varying pie rate.

Report of the Sub-Committee appointed to examine certain questions arising out of the proposals of the Government of India to vary the Meston Settlement in respect of Non-Judicial Stamps and Income-tax.

The Committee was constituted for the following purposes :—

(*a*) to examine the detailed proposals of the Central Government for the division between the Central and Provincial Governments of the stamp duties prescribed by Schedule I of the Indian Stamps Act, 1899 (Appendix A) ;

(*b*) to report whether any estimate of the resulting distribution of stamp revenue was possible ;

(*c*) to report on a statement (Appendix B) based on the latest figures received from Commissioners of Income-tax, showing personal income-tax incomes, the result of applying a three pie rate thereto, the loss to the Provinces of stamp revenue on the assumption that two-fifths of the total stamp revenue would become Central and the resulting fixed assignments ;

(*d*) to consider whether the income of Companies assessed to Super-tax should be included in the income on which the calculation of the assignment shall be based.

* * * * * *

4. [*Ref. Para. 1* (*a*)].—The Committee accepted the Central Government's proposals with the following modifications :—

(1) *Article 5.*—Instruments falling under class (*c*) to be Provincial.

(2) *Article 15.*—Instruments falling under this Article to be Provincial, unless they belong to a class which has been declared by the Central Government with the approval of Provincial Governments to be Central.

(3) *Article 34.*—To be Provincial.

(4) With the exception of Instruments covered by Articles 8 and 9, all Instruments falling under the Articles detailed in the List prepared by the Finance Department of the Government of India under the heading "Documents which may be Provincial or Imperial" to be Provincial.

Bombay and Bengal pointed out that by the inclusion of instruments falling under Articles 43 and 62 their Provinces would lose a very important source of potential revenue.

5. [*Ref. Para. 1 (b)*].—The majority of the members thought that it would not be possible to obtain estimates of any real value of the financial effect of distributing the receipts from stamp-duties between the Central and Provincial Governments. Bombay produced certain figures which indicated that the probable effect would be an equal division and it was suggested that in Bengal the result would be very similar The United Provinces believed that not more than 25 per cent. of the Provincial Stamp revenue would be transferred to Central as a result of the division The general view was that the proportions would vary greatly in the different provinces, although the Government of India's assumption that the Central share of the total stamp revenue would be roughly two-fifths of the whole might be not far from the mark.

6. [*Ref. Para. 1 (c)*].—Several members of the Committee expressed doubt regarding the correctness of the figures in column 2 of the Statement (Annexure B). It was explained that the accuracy of the figures could not be guaranteed and that the statement had been prepared merely to illustrate roughly the proposals of the Government of India and Mr. Loftus-Tottenham hopes that, more accurate figures would if possible be collected before any final distribution was made.

7. [*Ref. Para. 1 (d)*] —On the figures available Madras, Bombay, the United Provinces, the Punjab and the Central Provinces considered that the basis of assessment should be (*a*) personal incomes and not (*b*) the assessed income as defined in Devolution Rule 15 (2). Bengal and Burma were in favour of the latter basis and Bihar and Orissa and Assam were in favour of whichever alternative was the more profitable. The following figures were supplied by Mr. Loftus-Tottenham to show (in lakhs of rupees) the different results obtained by distributing 3¼ crores on these two bases :—

Province.	Basis (*a*).	Basis (*b*).
Madras	43·19	44·63
Bombay	107·48	94·39
Bengal	74·48	86·42
United Provinces.. ..	32·71	24·43
Punjab	22·08	24·22
Burma	29·35	38·36
Bihar and Orissa ..	18·13	14·28
Central Provinces ..	15·89	13·93
Assam	6·69	9·34

8. The views of the members of the Committee were then taken on the question whether the rate to be applied to the assessed income should be uniform for all the provinces or should vary from province to province. It was pointed out that a varying rate would obviate the need for fixed assignments or, in the event of the Government of India deciding to sacrifice the additional revenue (estimated at some Rs. 60 lakhs) required to render fixed assignments unnecessary, the probability of dissatisfaction among the provinces which did not share in the additional amount distributed. Madras and the Punjab declared in favour of a uniform rate; the United Provinces and Burma in favour of a varying rate; the remaining provinces considered that they had not sufficient information before them to decide. Bombay remarked that on the figures available they would be prepared to accept a uniform graduated rate.

9. The Committee discussed the suggestion, thrown out by the Auditor-General in the course of the morning's meeting of the Conference, that in view of the probability that the Royal Commission to be appointed under section 84-A of the Government of India Act, will examine the working of the Meston Settlement and of the delay which must be entailed by the attempt to obtain reliable figures and of the fact that the Government of India do not propose to introduce any change in the present Devolution Rule 15 until the provincial contributions have been extinguished, it is not worth while to upset the present arrangements. Bombay and Bengal maintained that immediate relief to some kind was required, but the other provinces felt that it would be advisable to make no change. Madras would not object to transfer the whole of the non-judicial stamp revenue in exchange for an increased assignment based on incomes assessed to income-tax, as originally proposed by the Government of India, but agreed with the majority in respect of the proposals as modified. It was pointed out that the introduction of Central non-judicial stamps as distinct from Provincial non-judicial stamps would probably inconvenience the public and that the proposal to give the Central Government either the whole or a share of the proceeds of stamp duties on instruments would involve divided control of the stamp administration which was one of the objections taken by the Meston Committee to the former alternative. A suggestion was made that uniformity of duty in respect of the instruments which it is proposed to include in the Central list could be secured by reserving them for Central legislation without crediting the duties to Central and that the Provinces could be compensated by assignments for any reductions which the Central Government considered it advisable to make in the duties on these instruments in the interests of trade.

APPENDIX A (to Report of Sub-Committee).

Division of stamp duties between the Central and Provincial Governments as proposed by the Government of India.

(The numbers of the articles are those in Schedule I of the Indian Stamp Act of 1899).

Imperial.

(*a*) Documents now reserved for Imperial legislation.—

1. Acknowledgment.
13. Bill of Exchange.
19. Share certificate.
21. Cheque.
28. Delivery order in respect of goods.
36. Letter of allotment of shares.
37. Letter of Credit.
47. Policy of insurance.
49. Promissory note.
52. Proxy.
53. Receipt.
60. Shipping order.

(*b*) Other documents which for administrative or other reasons should be taxed by the Central Government.

5. Agreement relating to sale of a bill of exchange, Government Security.
10 Articles of Association of a company.
14. Bill of lading.
15. Certain classes of bonds.
16. Bottomry bond, that is an instrument by which the Master of sea-going ship borrows money on the security of the ship to enable him to preserve the ship or prosecute a voyage.
17. Instrument of Cancellation (to follow the instrument cancelled).
20. Charter party, that is any instrument where by a vessel or some specified principal part thereof is let for the specified purposes of the charterer.
24. Copy or extract (where the officer is under the Central Government).
25. Counter part or duplicate (to follow original).
26. Customs bond.
27. Debenture.
34. Indemnity bond.
39. Memorandum of Association of a company.
43. Note or memorandum sent by the broker or agent to his principal intimating the purchase or sale on account of such principal.
44. Note of protest by the Master of a ship.
46. Instrument of partnership.

50. Protest of bill or note, that is, any declaration in writing made by a notary public or other person lawfully acting as such attesting the dishonour of a bill of exchange or a promissory note.

51. Protest by the Master of a ship that is, a declaration of the particulars of a voyage drawn up by him with a view to the adjustment of losses, etc.

56. Respondentia bond, that is, an instrument securing a loan on the cargo laden or to be laden on board a ship and making repayment contingent on the arrival of the cargo at the destination.

59. Share warrant to bearer issued under the Indian Companies' Act, 1882.

62. Transfer of—

(a) Shares in a company;

(b) debentures, marketable securities,

(c) any interest secured by a policy of insurance, etc.

65. Warrant for goods.

Provincial.

2. Administration Bond including bonds given under section 256 of the Indian Succession Act of 1865, Section 78 of the Probate and Administration Act of 1881, or Section 9 or Section 10 of the Succession Certificate Act of 1889.

4. Affidavit.

7. Appointment in execution of a power whether of trustees of property moveable or immoveable where made by any writing, not being a will.

11. Articles of Clerkship or contract whereby any person first becomes bound to serve as a clerk in order to secure admission as an attorney in any High Court.

12. Award.

15. Bonds (certain classes only).

17. Cancellation (if instrument is in this class).

18. Certificate of sale granted to the purchaser of any property sold by public auction by civil or revenue court by Collector or other revenue officer.

24. Copy of extract given by officer under the provincial Government.

25. Counter part or duplicate of documents included in this class.

30. Entry as an Advocate, Vakil or Attorney on the roll of any High Court.

42. Notarial Act.

48. Power of Attorney, not being a proxy.

Documents which may be Provincial or Imperial.

5. Adoption deed.

6. Agreement relating to title deeds.

8. Appraisement or valuation made otherwise than under an order of the court in the course of a suit.

9. Apprenticeship deed.
22. Composition deed.
23. Conveyance.
29. Instrument of divorce.
31. Exchange of property.
32. Instrument of further charge, that is, an instrument imposing a further charge on mortgage property.
33. Gift.
35. Lease.
38. Letter of license, that is, an agreement between a debtor and his creditors that the latter shall, for a specified time, suspend their claims and allow the debtor to carry on business at his discretion.
40. Mortgage deed.
45. Partition.
54. Reconveyance of mortgage property.
55. Instrument of release, that is, an instrument whereby a person renounces his claim upon another person against any specified property.
57. Security bond or mortgage deed.
58. Settlement.
61. Surrender of lease.
63. Transfer of lease.
64. Declaration or revocation of trust.

APPENDIX B (to Report of Sub-Committee).

Porvince.	Personal Incomes (In Crores) (Super-tax incomes omitted).	Proceeds of 3 pies rate (In lakhs).	Loss in stamp Revenue by the transfer of non-judicial stamps to Central Government (In lakhs).	Fixed assignments (In lakhs).
(1)	(2)	(3)	(4)	(5)
Madras	17 51	27·36	43·27	+15·91
Bombay	40 39	63·11	45·79	—17·32
Bengal	26 34	41·16	51·69	+10·53
United Provinces	13 29	20 77	16·81	—3·96
Punjab	8 96	14·00	16·44	+2·44
Burma	11 39	17·80	13·51	—4·29
Bihar and Orissa .	7 09	11·08	8·92	—2·16
Central Provinces .. .	6 30	9·84	10 10	+·26
Assam	2 78	4·34	2·77	—1·57
Total .	1,34·05	2,09·46	2,09·30	

NOTES.—*Col. 2.*—Revised figures based on three years' average.

Col. 3.—The figures represent the distribution by provinces of a total assignment of 2,09·46 lakhs, representing the assumed loss to Provincial Revenues of approximately two-fifths of their receipts from non-judicial stamps.

Col. 4.—These figures represent in each case approximately two-fifths of the provincial receipts from non-judicial stamps.

Col 5.—The figures repesent the difference between Cols. 3 and 4. They take no account of assignments under Devolution Rule 15 or of temporary assignments (*e.g.*, of Customs duties).

Third meeting of the Conference held on the 17th November 1926.

The report of the Sub-Committee appointed on the 16th to consider the points arising out of the scheme for the revision of the Meston Settlement was read and the discussion on the subject resumed. The following general propositions were agreed to pending examination of the whole subject by the Statutory Commission :—

(1) It is desirable in principle that certain of the stamp duties (broadly those suggested by the Finance Department of the Government of India and accepted with slight modifications by the sub-committee) should become central sources of revenue, provided that the provinces are adequately compensated for the loss both of actual revenue and of potential increases of revenue.

(2) It is desirable that a new formula should be found to replace Devolution Rule 15 of such a character as to give each province an interest in receipts from taxes on income which will reflect the growing prosperity of the province as measured by assessment, provided that the amount payable to each province should not be less than it would get under Devolution Rule 15. It was understood that the question of the assessment which should be adopted as the basis of the formula would remain open. The alternatives include the following :—

(*a*) total assessable incomes in each province ;

(*b*) personal imcomes only, including dividends from companies, wherever situated, of assessees resident within the provinces

(*c*) personal incomes *plus* incomes asses; able to super-tax ;

(*d*) personal incomes *plus* companies' income.

(3) No modification ought to be made in the direction of increasing the sums payable out of the proceeds of central revenue to any particular province until the Government of India have first extinguished the provincial contributions. (Bombay dissented while Bihar and Orissa remained neutral.)

(4) It is not desirable to effect major changes in the Meston Settlement as regards the taxes allocated to central and provincial Governments respectively or as regards the relative position of one province to another. (Bombay and Bengal dissented and maintained their demand for a complete revision of the Settlement.) Bihar stated that they had never accepted the Meston Settlement as a satisfactory final arrangement, and referred to the last paragraph of their official letter as representing their views.

Burma agreed provided that the question of the rice duty was not held to be a major change. Central Provinces and United Provinces asked that the question of the Famine Insurance Fund already discussed should not be excluded from prior consideration. Assam also asked that the question of the tea duty should remain open.

(5) It is desirable to arrive at a settlement of questions 1 and 2 in such a way as to secure that as soon as the provincial contributions are extinguished the new formula regarding income-tax may come into force giving to each province an assignment in respect of income-tax varying with the income-tax assessments of each year (the question on what assessments the formula should be based being left open) which will not be less than is sufficient to compensate it for any loss of stamp revenue and for the assignment which it would receive or expect

hereafter to receive under Devolution Rule 15 as it stands, such assignment also if possible to absorb existing temporary assignments, if any. (Bombay agreed subject to the condition that in fixing the assignments, the fact that Bombay had suffered in a marked degree on account of the defective operation of Devolution Rule 15 should be taken into consideration. They maintained a right to payment of arrears under the rule, as it ought to have operated if the basis had been equitable.)

(6) It is desirable that the new formula should be uniform for all provinces if possible. But at the same time if the new formula is such as to give greater increases of revenue to same provinces than to others the advantage gained by one province over another should not be so great as seriously to disturb the balance established between province and province by the Meston Settlement.

1927.

LETTER FROM THE HON'BLE MR. A. F. L. BRAYNE, C.I.E., I.C.S., SECRETARY TO THE GOVERNMENT OF INDIA, TO ALL PROVINCIAL GOVERNMENTS, No. F. 11-XII—F., DATED SIMLA, THE 26TH SEPTEMBER 1927.

SUBJECT.—*Readjustments within the Meston Settlement.*

I am directed to refer to Mr. Jukes' letter No. F. 116 (V)-F./26, dated the 13th August 1926, on the above subject, in which the Government of India invited the opinions of Provincial Governments on the proposals —

(a) to transfer non-judicial stamps to the Central Government;

(b) to re-imburse Provincial revenues by means of the proceeds of a flat rate of income-tax on personal assessable incomes from all sources (including dividends from companies, wherever situated) *plus* personal supertax incomes of assessees resident within the province; and

(c) to make good the resulting Provincial deficits by means of annual fixed assignment from the Central Government which would remain unchanged indefinitely, the amounts of such assignments being so calculated as to place the Provinces in approximatly the same financial position at the outset as if no change had been made in the Meston Settlement.

The objections raised to the scheme and the alternatives proposed by the Provincial Governments in their replies were examined at considerable length by a sub-committee of the Conference of Financial Representatives held in November 1926 and the conclusions that emerged from these

discussions were embodied in a series of propositions which, subject to certain important reservation, were agreed to by the Conference, pending examination of the whole subject by the Statutory Commission. These conclusions may briefly be summarised as follows :—

(1) Stamp duties on documents which are of a commercial or *quasi*-commercial character should be transferred to the Central Government, the Provinces to retain conveyances, mortgages, leases and other important revenue-yielding items ; and the Provinces should be adequately compensated for the loss of revenue from this source, actual as well as potential.

(2) A new formula for the division of income-tax should be found to replace Devolution Rule 15 of such a character as to give each Province an assignment in respect of income-tax varying with the income-tax assessments of each year which will not be less than what is sufficient to compensate it for any loss of stamp revenue and for the assignments which it would receive or expect hereafter to receive under Devolution Rule 15 as it stands.

(3) It is not desirable to effect major changes in the Meston Settlement as regards the taxes allocated to Central and Provincial Governments respectively or as regards the relative position of one Province to another.

(4) No modification involving payments out of the proceeds of Central Revenues to any paticular Province should be made in the Settlement until the Government of India have first extinguished the Provincial contributions.

2 I am now to explain the detailed proposals which have been formulated with reference to the principles indicated in these propositions. The Government of India have tentatively decided to accept the recommendations of the sub-committee regarding the centralization of commercial and *quasi*-commercial instruments, and they propose to give effect to them from the 1st April 1928. The instruments which are to be centralized are shown in Annexure A to this letter.

3. The division of the income-tax, which I am next to deal with has presented very great administrative difficulties in almost every country in which attempts have been made to distribute the proceeds of this tax on a rational basis. The problem was investigated by the League of Nations with the assistance of eminent economists in connection with the avoidance of double income-tax. It has been examined at great length with special reference to the peculiar conditions of India by the Taxation Enquiry Committee in paragraphs 528-538 of their report. The Committee made an attempt to apportion the proceeds of the tax according to the principles of the origin of the income and the domicile of the assessee, but they found the practical difficulties almost insuperable and they came to the conclusion that the only

possible method was to base the distribution primarily on the principle of domicile, which also underlies the final conclusion of the committee of experts appointed by the League of Nations. They recommended that the Provinces should be given the proceeds of a graduated rate on personal incomes of assessees from all sources, including dividends from companies wherever situated. In partial recognition of the principle of origin, they also suggested that each Province should be given a *small* portion of the receipts from the super-tax on companies. The Government of India examined in great detail the latter proposal, but they found that the preliminary adjustment of the collections of each Province to meet the case of profits earned in several Provinces but taxed in only one, which is essential for the distribution of the super-tax on companies on an equitable basis, could only be made on assumptions of an extremely hypothetical character. The Committee themselves did not make any claim that their scheme had any pretensions to scientific accuracy, they recommended it primarily on the ground that "it is easily comprehensible bearing its merits and demerits on its face, that it can be applied directly by the use of returns already in use and that it gives as much recognition to the principles laid down by economists as is possible in the conditions obtaining in India". The Government of India, therefore, examined various alternatives and provisionally suggested that the simplest plan would be to give the Provinces the proceeds of a flat rate on personal incomes *plus* personal super-tax incomes. They recognised clearly at the time that this formula was in some respects illogical, since the super-tax in India is a distinct tax and is levied *in addition* to the income-tax on the portion of the income exceeding Rs. 50,000 or in the case of Hindu Undivided Families Rs. 75,000. They, however, accepted it primarily on the supposition that it would give the industrial Provinces of Bengal and Bombay, where most of the super-tax is collected, a larger and more equitable portion of the income-tax than they would get if only personal incomes were taken as the basis, as suggested by the Taxation Enquiry Committee. Subsequent statistical investigations, based on the actual figures of personal incomes and personal super-tax incomes, however, have shown that Bombay and Bengal, so far from benefiting by the adoption of this formula, would actually lose owing to the fact that the initial pie rate would be lower if the super-tax incomes were added to the ordinary incomes. This is a result of the fact, established by statistics, that, during a period of improving trade, super-tax incomes in India do not invariably increase in a higher proportion than personal incomes. After fully considering the alternatives the Government of India have, therefore, finally decided to adhere to the conclusion, which was provisionally announced by the Hon'ble the Finance Member at the Conference of Financial Representatives held in November last, that it would be preferable to base the assignment on personal incomes only.

4. The next step is to determine a pie rate to be applied to personal incomes which will give to

each of the Provinces an amount not less than the total of—

(a) the revenue which the Provinces will lose if the instruments specified in Annexure A were centralised ;

(b) the average assignments which the Provinces receive under Devolution Rule 15 as it stands ; and

(c) the amounts of revenue assignments of a recurring nature (other than those which are in the nature of payments for specific services rendered) which are made to the Provinces under present arrangements. These are generally excise assignments.

Since the revenue from non-judicial stamps is classified in the Provincial administration reports according to the kind of stamp used and not, in all cases, according to the nature of the documents, it has proved a difficult task to obtain accurate estimates of the revenue from stamp duty on instruments proposed for transfer to the Central Government. The figures in column 5 of the statement in Annexure B are based on such information as the Provincial Governments have been able to supply and on independent calculations made by the Central Board of Revenue. It will be observed from the statement that the proceeds of income-tax at the rate of three pies in the rupee on personal incomes would, except in the case of Assam, cover the loss to the Provincial Governments which would result from the adoption of the proposals for the centralisation of certain stamps and for the abolition of the assignments under Devolution Rule 15 and other revenue assignments. In the case of Burma, also, if the budget estimate of the assignments under Devolution Rule 15 for 1927-28 were adopted as the basis of calculations, there would be a slight deficit. I am, however, to point out that both in the case of Burma and Assam, the comparatively large assignments under this rule have followed not from any marked expansion of non-agricultural income, but from certain fortuitous circumstances. The income of tea companies in Assam forms the major portion of the assessed income in that Province. These companies were assessed to income-tax for the first time *after* 1920-21, which is the basic year adopted for the calculations under Devolution Rule 15. The comparatively large assignments which Assam has enjoyed are therefore due almost entirely to a change in the law of income-tax. In Burma, on the other hand, until a comparatively recent date there existed no properly organised machinery for the assessment of income-tax outside Rangoon city. With the extension of the activities of the Income-Tax Department to the moffusil districts in this Province, the assignments under Devolution Rule 15 have increased in a marked degree. In the case of Bengal, while the initial benefit is not very considerable on the statistics adopted in Annexure B, it must be realised that the standard of income-tax assessment is much lower than it ought to be. The Central Board of Revenue are engaged in further efforts to improve the efficiency of the income-tax administration in Bengal and this, together with the general improvement in trade, will enable the Province to enjoy a much larger

and increasing benefit from the arrangement proposed. The Government of India propose that, if in the case of any Province the proceeds of the three pie rate are less than the compensation (calculated on the figures of the last three years) which is due to the Province under the readjustment now contemplated, the difference will be made good by means of an assignment from Central revenues, until the question of the future financial relations between the Central Government and the Provincial Governments has been settled after the enquiry by the Statutory Commission.

5. The Government of India would propose to take advantage of this opportunity to remove certain minor fiscal anomalies which, though of a comparatively trivial character from the point of view of revenue, involve general principles to which they attach very great importance. Court fees are now levied under the Indian Court Fees Act, 1870, on certain classes of documents relating to proceedings before officers in the Customs, Income-tax and Salt Departments of the Government of India. A list of such documents is given in Annexure C to this letter. Since a fee is essentially in the nature of a payment for services rendered, little justification exists for the levy by Provincial Governments of a charge for service rendered by officers directly under the Central Government. The Government of India propose to abolish these fees with effect from the 1st April 1928. It would, of course, be open to them to revive these court fees as fees payable to the Central Government by a special Act of the Central legislature, if experience showed this to be desirable later.

6. I am also to refer in this connection to the export and import duties levied under various Forests Acts. Under section 3 of the Burma Forests Act of 1902, 'forest royalties', which are of the nature of export duties are levied on rubber, lac, kalaw seeds, sunletthe, wild birds, etc. These duties are actually collected by the Imperial Customs officers. The revenue from these royalties in the years 1924-25 and 1925-26 was Rs. 4·95 lakhs, and Rs. 4·62 lakhs, respectively. Under the powers conferred by section 39 of the Indian Forests Act of 1878, local Governments have also in many cases, with the previous sanction of the Governor General in Council, levied import duties on timber entering their territories from outside British India. The revenue from these import duties in Bombay and United Provinces amounted on an average to Rs. 16,000 and Rs. 38,000, respectively, during the last three years. In the case of Burma, the principal justification for this practice lies apparently in the fact that the geographical features of the Province render it difficult to collect forest royalties in any other manner, and the Government of India do not propose that the power given under section 3 of the Burma Forests Act of 1902 to impose these forest royalties should be withdrawn under present conditions. In the case of the other Provinces affected, I am to suggest that the administrative justification for the continuance of the import duties should be re-examined. The Government of India consider it desirable to delete from the

Indian Forests Act and from the Provincial Forests Acts the powers given to local Governments to levy import duties on timber entering their territories from outside British India, unless such a course would cause serious administrative inconvenience. If the local Governments, except Burma, agree to the abolition of these duties, the loss of revenue thus entailed will be taken into consideration in connection with the revision of the present settlement.

7. The proposals on which I am to invite the opinions of the Provincial Governments may briefly be summarised as follows :—

(1) Stamp duties on the documents specified in Annexure A should be transferred to the Central Government.

(2) The Provinces should be given a share of the income-tax at the rate of three pies in the rupee on personal assessable incomes from all sources of assessees resident within the Province.

(3) The assignments under Devolution Rule 15 and other revenue assignments, which are not in the nature of payments for specific services rendered should be abolished.

(4) The Indian Court Fees Act, 1870, should be amended so as to abolish the fees on all documents relating to proceedings before officers of the Income-tax, Salt and Customs Departments of the Government of India.

(5) The import duties levied under the Forest Acts on timber coming into a Province from outside British India should also be abolished.

(6) If, in the case of any Province, the proceeds of the three pie rate are less than the loss of revenue from (1), (3), (4) and (5), the difference should be made good by means of an assignment from Central Revenues until the question of the future financial relations between the Central Government and the Provincial Governments is settled after enquiry by the Statutory Commission.

It will be observed from the statement in Annexure B that the proposed readjustment is likely to result in an initial sacrifice by the Central Government of nearly Rs. 65 lakhs (without allowing for further loss resulting from a possible reduction of the stamp duties on particular instruments in certain Provinces, designed to secure uniformity). Subject to the approval of the Secretary of State the Government of India propose to give effect to the revised settlement with effect from the 1st April 1928, provided their financial position then permits of the final extinction of the Provincial contributions and also of the sacrifice of revenue involved in this and other schemes under contemplation. I am to request that a reply to this letter may be sent to the Government of India before the 1st November next so that it may be possible to discuss these proposals at the next Conference of Financial Representatives.

ANNEXURE A.

INSTRUMENTS THE STAMP DUTIES ON WHICH WILL BE CREDITED TO THE CENTRAL REVENUES.

(The numbers of the articles are those given in Schedule I of the Indian Stamp Act of 1899).

1. Acknowledgment.

5. (*a*) & (*b*) Agreement relating to sale of a bill of exchange, Government security or company shares.

8. Appraisement or valuation made otherwise than under an order of the court in the course of a suit.

9. Apprenticeship deed.

10. Articles of Association of a company.

13. Bill of exchange.

14. Bill of lading.

16. Bottomry Bond, that is, an instrument by which the master of a sea-going ship borrows money on the security of the ship to enable him to preserve the ship or prosecute a voyage

17. Instrument of cancellation (to follow the instrument cancelled).

19. Share certificate.

20. Charter party, that is, any instrument whereby a vessel or some specified principal part thereof is let for the specified purposes of the charterer.

21. Cheque.

24. Copy or extract where the officer is under the Central Government.

25. Counterpart or duplicate (to follow original).

26. Customs Bond.

27. Debenture.

28. Delivery order in respect of goods.

36. Letter of allotment of shares.

37. Letter of credit.

39. Memorandum of association of a company.

43. Note or memorandum sent by a broker or agent to his principal intimating the purchase or sale on account of such principal

44. Note of protest by the master of a ship.

46. Instrument of partnership.

47. Policy of insurance.

49. Promissory note.

50. Protest of bill or note, that is any declaration in writing made by a notary public or other person lawfully acting as such attesting the dishonour of a bill of exchange or a promissory note.

51. Protest by the master of a ship, that is, a declaration of the particulars of a voyage drawn up by him with a view to the adjustment of losses, etc.

52. Proxy.

53. Receipt.

56. Respondentia bond, that is, an instrument securing a loan on the cargo laden or to be laden on board a ship and making repayment contingent on the arrival of the cargo at the port of destination.

59. Share warrant to bearer issued under the Indian Companies Act, 1882.

60. Shipping order.

62. Transfer of—

(a) shares in an incorporated company or other body corporate;

(b) debentures, marketable securities;

(c) any interest secured by a policy of insurance, etc.

65. Warrant for goods.

ANNEXURE B.

[In lakhs of rupees.]

Province.	Personal incomes assessed to Income-tax. (a)			Estimate of Stamp revenue from Stamps to be centralised (c)	Assignment under Devolution Rule 15 (Average of last 2 years)	Other revenue assignments	Total of columns 5, 6 and 7.	Income-tax on personal incomes at 3 pies in the rupee.
	1925-26.	1926-27.	Average of 2 years.					
1	2	3	4	5	6	7	8	9
Madras	19,42	20,53	19,98	26 84	2·92	.	29 76	31·22
Bombay	40,60	37,09	38,85	38 00	.		38·00	60·70
Bengal	28,74	29,46	29,10	42 00	.	..	42 00	45·47
United Provinces .	13,89	13,67	13,78	7 00	·01	(b) ·62	7·63	21·53
Punjab	10,15	12,91	11,53	8·00	2 86	(b) 6 97	17·83	18·02
Burma	13,25	11,78	12,51	12 00	7·41	.	19·41	19·55
Bihar and Orissa .	7,45	8,06	7,75	1·50	2·48	..	3·98	12·11
Central Provinces ...	6,76	7,27	7,02	2 00	1 83	..	3·83	10·97
Assam	3,30	3,19	3,25	·30	5 41	..	5 71	5·08

(a) These figures were specially obtained from the Commissioners of Income-tax.
(b) Assignment for loss of still head duty.
(c) Includes assignment on account of unified stamps.

ANNEXURE C.

Indian Court Fees Act, 1870.

Schedule I, Article 6.—These documents will become liable to stamp duty under the Indian Stamp Act, 1899, when the court fee is abolished.

Schedule I, Article 9.—This applies to the proceedings or orders issued by all officers in the Customs, Income-tax and Salt Departments.

Schedule II, Article 1 (a).—Customs officers specifically mentioned in clause (a) of Article (1). The term "Executive Officer" in paragraph 4 of this clause includes officers in the Income-Tax and Salt Departments.

Schedule II, Article 1 (c).—Under the Sea Customs Act of 1878 and the Income-tax Act of 1922, the Central Board of Revenue is a "Chief Controlling Executive Authority" and under the Salt Act of 1882 the Commissioner of Northern India Salt Revenue is a "Chief Controlling Executive Authority."

Schedule II, Articles 10 (a) and 11 (a).—The term "Executive Officer" in these Articles includes all Customs, Income-tax and Salt Officials.

Schedule II, Articles 10 (c) and 11 (b).—These apply to the Central Board of Revenue or Commissioner of Northern India Salt Revenue, as the case may be.

FROM THE FINANCIAL SECRETARY TO GOVERNMENT, CENTRAL PROVINCES, No. C. 101/823-B.—X, DATED PACHMARHI, THE 15TH OCTOBER 1927.

In reply to your letter No. F. 11-XII-F., dated 26th September 1927, I am directed by the Governor in Council to say that this Government accepts the proposals outlined in paragraph 7 of the letter under reference.

FROM G. T. BOAG, ESQ., I.C.S., SECRETARY TO THE GOVERNMENT OF MADRAS, No. 32383-ACCTS.—5, DATED FORT ST. GEORGE, THE 29TH OCTOBER 1927.

SUBJECT.—*Re-adjustments within the Meston Settlement—Reference letter from the Government o India, Finance Department, No. F.-11-XII-F., dated the 26th September 1927, and telegrams dated the 8th and 13th October 1927.*

In reply to the letter referred to above, I am directed to state that the Madras Government accept the several proposals, made by the Government of India which are summarised in paragraph 7 of their letter.

2. With reference to paragraph 5 of the letter, I am to state that the loss to Madras Provincial revenues on account of the proposed amendment of the Indian Court Fees Act so as to abolish the fees on all documents relating to proceedings before officers in the Customs, Income-tax and Salt Departments of the Government of India, will amount to about Rs. 20,000 per annum.

As regards paragraph 6 of India's letter, I am to state that no import duties under the provisions of the Forest Act are levied by the Madras Government on timber entering their territories from outside British India.

3. The Government of Madras note that the Government of India propose to give effect to the revised settlement with effect from the 1st April 1928, provided their financial position then permits of the final extinction of the Provincial contributions and also of the sacrifice of revenue involved in this and other schemes under contemplation.

FROM P. C. TALLENTS, ESQ., I.C.S., SECRETARY TO THE GOVERNMENT OF BIHAR AND ORISSA, No. 10680-F., DATED PATNA, THE 23RD OCTOBER 1927.

I am directed to refer to Mr. Brayne's letter No. F.-11-XII-F., dated the 26th September 1927, and to say that the opinion of the Government of Bihar and Orissa on the six points enumerated in paragraph 7 is as follows :—

(1) The local Government have no objection to the transfer to the Central Government of the stamp duties on the documents specified in Annexure A.

(2) The local Government agree that for the Central Government to assign to each province a share of the income-tax at the rate of 3 pies in the rupee on personl assessable incomes from all sources of assessees resident within that province is a fair method of distributing between the provinces

concerned the revenue which the Government of India propose to make over to them.

(3) If effect is given to this proposal the local Government agree to the abolition of the assignments under Devolution Rule 15 and of the revenue assignments which are not in the nature of payments for specific services rendered. In this connexion I am directed to say that the local Government do not desire to press the objection taken in my letter No. 3002-F.R., dated the 1st September 1927, written before Mr. Brayne's letter was received, regarding the withdrawal of the assignment for the refund of customs duty on Government stores.

(4) The local Government have no objection to the amendment of the India Court Fees Act, 1870, so as to abolish the fees on all documents relating to proceedings before officers of the Income-tax, Salt and Customs Departments of the Government of India.

(5) No import duty is levied under the Forest Act on timber brought into Bihar and Orissa from outside British India. The local Government have no objection to the abolition of such duties.

(6) It appears to be certain that in the case of Bihar and Orissa the proceeds of the 3 pies rate will substantially exceed the loss of provincial revenue that will result from the above proposals. This Government are not directly interested in the method of making good the deficits in the case of other provinces. They see however no objection to the Government of India's proposal.

FROM H. W. EMERSON, ESQ., C.I.E., C.B.E., I.C.S., SECRETARY TO GOVERNMENT, PUNJAB, FINANCE DEPARTMENT, No. 27367-B., DATED LAHORE, THE 31ST OCTOBER 1927.

SUBJECT.—*Re-adjustments within the Meston Settlement.*

I am directed to refer to Mr. Brayne's letter No. F.-11/XII-F., dated the 26th September 1927, on the subject, and to convey the views of the Governor in Council on the specific proposals which are summarised in para. 7 of the letter.

2. On the understanding that Provincial Governments will be adequately compensated for any loss of revenue that may occur, the Governor in Council has no objection to urge against the transfer of the stamp duties on the documents specified in Annexure 'A' from the Provincial Government to the Central Government; or against the amendment of the Indian Court Fees Act with the object stated in para. 5 of the letter; or against the abolition of the import duties on timber as proposed in para. 6 of the letter.

3. I am to say, however, that he is unable to regard as equitable the change in the Meston Settlement which it is proposed to make in order to compensate the various provinces for the losses incurred. In the first place, he is not satisfied that the methods of calculation adopted adequately represent the financial effects that would follow the adoption of the proposals. He observes that the figures given in columns 4 and 6 of Annexure 'B'

are based on the averages of two years only and he does not consider that a period of two years is sufficiently long on which to base proposals of so important a character. The data is not available by which the figures in column 4 of the Annexure can be checked, but the figure for the Punjab in column 6 is evidently the average of the two years 1924-25 and 1925-26, when the assignments amounted to 1·90 and 3·82 respectively. The assignment in 1924-25 was in fact much less than in any year since the Reforms and the average assignment is not less than Rs. 4 lakhs.

In the second place, the Governor in Council is unable to understand the reasons for the inclusion in the proposed settlement of the "other revenue assignments" shown in column 7 of the Annexure. While he is prepared to admit that there might be some advantage in merging such assignments into a general settlement if they were common to all provinces, and if a settlement could be reached which would leave the relative position of provinces practically unchanged, he can see no justification for their inclusion when they are peculiar to two provinces, in one of which the amount is small, and when their inclusion, instead of redressing the inequalities of the settlement, has the contrary effect of accentuating them. It would almost appear that they have been included in order to make good to the Government of India, at the expense mainly of the Punjab, some portion of the sacrifice of revenue which they propose to distribute to other provinces.

4. These, however, are matters of detail. A general ground of objection, and one to which the Governor in Council attaches much importance, is the fact that the proposals go far beyond the immediate objects to be attained and involve a modification of the Meston Settlement with results that are very unequal for different provinces. According to the figures given in Annexure 'B', the settlement proposed will result in a gain of Rs. 22 lakhs to Bombay, of 14 lakhs to United Provinces, of 8 lakhs to Bihar and Orissa, of 7 lakhs to Central Provinces, of 3 lakhs to Bengal, with the prospect of a rapid increase, and of 1 lakh to Madras. Burma, Assam and the Punjab, on the other hand, will gain nothing. The settlement will involve an initial sacrifice by the Government of India of Rs. 65 lakhs, and while the Governor in Council appreciates their willingness to make this sacrifice, he is strongly of the opinion that the distribution of surplus resources by the Central Government should be made in such a manner as to leave practically unchanged the relative financial position of the various provinces, and that it should not be made in such a way as to give marked preference to certain province. In particular, he is unable to appreciate the reasons for the preference which it is proposed to show to Bombay, or the principles on which it can be supported.

5. While, therefore the Governor in Council is prepared, to accept the proposals contained in sub-paras. (1), (4) and (5) of para. 7 of the letter under reply, he is of the opinion that any consequential financial adjustments should be strictly confined to the grant of the necessary compensation to the

various provinces, and, that therefore, since no other means of settlement appear to be practicable at the present time, the compensation should take the form of cash assignments. He considers that no other change should be made in the Meston Settlement, which should be left for examination by the Statutory Commission, to be appointed under section 84 (*A*) of the Government of India Act and before which the different provinces will presumably be given an opportunity of presenting their cases.

FROM G. WILES, ESQ., C.I.E., I.C.S., SECRETARY TO THE GOVERNMENT OF BOMBAY, FINANCE DEPARTMENT, NO. 5029 7616-A., DATED POONA, THE 1ST/2ND NOVEMBER 1927.

I am directed to reply to Mr. Brayne's letter No. F.-11/XII-F., dated the26th of September last. The letter deals with two proposals :—

(*a*) the transfer of the revenue from certain heads of non-judicial stamps to the Central Government ;

(*b*) reimbursement of provincial revenues by means of a flat rate on income-tax on personal assessable incomes.

The Government of India have now calculated that the revenue from stamp duties, which it was agreed in last year's conference to credit to central revenues, will amount to 38 lakhs ; and they put forward the proposal that a flat rate of 3 pies on personal assessable incomes from all sources of assessees resident within the province should be given to the provinces. Further minor proposals are made to abolish existing assignments, and certain court fees and duties.

2. In regard to the minor proposals contained in sub-sections 3 and 4 of paragraph 7 of Mr. Brayne's letter, I am to say that the Government of Bombay accept these proposals. In regard to the proposal to abolish duties on timber and other forest produce, I am to say that the Government of Bombay will address the Government of India separately on this question. The subject does not seem germane to the present discussion, and there seems no particular reason why it should be introduced into it. On the major proposals I am directed to make the following comments.

3. In regard to the figure of 38 lakhs, the estimated figure of the stamp revenue to be surrendered, I am to say that the Government of Bombay wish to be enlightened further regarding the method by which the figure has been arrived at. In our letter No. 5007-A., dated 19th May 1927 we divided the instruments concerned into two classes :—

(*a*) documents now reserved for central legislation ; and

(*b*) other documents which for administrative and other reasons should be attached to the Central Government.

The estimate of the revenue in class (*a*) was in

1924-25	.. ..	35½ lakhs, and in
1925-26	.. ..	32½ lakhs.

and we stated that the Superintendents of Stamps reported that they had no means of estimating re-

ceipts from class (*b*). The estimate of 38 lakhs now given by the Government of India implies that the total revenue estimated to be received from class (*b*) does not exceed from 3 to 5 lakhs. In the absence of any detailed statement it is inevitable for the Government of Bombay to feel doubt about the accuracy of the estimate.

4. I come now to the question of "personal incomes". Mr. Brayne's letter estimates the average of personal incomes assessed to income-tax for the past two years at 38 crores. No information is given in Mr. Brayne's letter as to the method followed in calculating this figure; and I am instructed to put forward certain considerations which have led the Government of Bombay to believe that the calculations cannot be accepted. I attach a statement containing for the three years 1923-24 to 1925-26 the figures of personal incomes as given by the Government of India, and the figures of income as given in the Income-Tax returns Nos. III and IV. It will be seen that in 1923-24, the total assessed income was 216 crores, while the personal income as calculated by the Government of India was 126 crores. In 1924-25 the figures are 189 and 132 crores; and in 1925-26 197 crores and 143 crores. (It may be noted in passing that in 1923-24 the figure of personal incomes was very considerably less than the income given in return No. IV, a fact which is explicable on the assumption that the incomes given in return No. IV must all be "personal income"). In the next place there is a difference between the total personal income and the total assessed income of not less than 90 crores in 1923-24; 57 crores in 1924-25, and 54 crores in 1925-26. Now if we follow the definition of "personal income" which was given by the Taxation Enquiry Committee, the figures of personal income should be those calculated from the returns submitted under section 22 (2) of the Income Tax Act; and in consequence the total of the personal incomes of the provinces should be equal to the total assessed incomes as given in returns III and IV after making allowance for the incomes of foreigners and undistributed profits. It seems open to grave doubt that the differences of 90, 57 and 54 crores, which I have given above, should be accounted for entirely by the income of foreigners and undistributed profits.

5. This illustrates the difficulty which the Government of Bombay have in arriving at an opinion on the proposals put forward. The figure of personal income as calculated by the Government of India is at the most 80 per cent. and at the worst 70 per cent. of the total assessed income in the years for which the Government of India have given as figures and it is evident that in better years the percentage would be even less. On the one side, therefore, we have a doubtful figure for the income to be surrendered by the local Government of 38 lakhs. It may be added that this figure apparently ignores the prospect of increasing revenue under this head from items such as the taxation on stock exchange transactions which have been recommended by the Taxation Enquiry Committee and to which the representatives of this Government drew special attention at the time of the discussion last year. On the other side we have extremely doubtful calculation of the figure of "personal incomes."

6. In the opinion of the Government of Bombay this difficulty of calculating the tax derived from personal incomes to be recurring; and always to be a bone of contention between the Central Gveornment and the provinces. And it must not be forgotten that the administration of Income Tax is entirely under the control of the Central Government. I am to say, therefore, that the Government of Bombay consider it to be essential, before they can agree to these proposals, that a satisfactory method of calculating personal incomes should be determined; and they prefer the alternative, which will avoid the possibility of constantly recurring friction, of basing the distribution of the income tax, not on personal incomes, but on total assessed income. It may indeed be claimed that this will unduly favour the industrial provinces at the expense of the agricultural provinces; but it may be answered that the benefit is not great and is more than off-set by the disability under which the industrial provinces have suffered since the introduction of the Meston Settlement.

7. On the question of the proposed flat rate of 3 pies, I am instructed to repeat the proposal made last year by the Government of Bombay that the share of the provinces should be calculated not on a flat pie rate, but on a graduated pie rate as recommended by the Taxation Enquiry Committee. It is an admitted fact that only by a graduated pie rate can industrial provinces have a fair share in the growing prosperity of their own industries.

8. Finally the Government of Bombay would press for a share in the super-tax as being the only way in which the industrial provinces can fully share in the prosperity of their province. And in this connection I am to point out that, while in 1926-27 the super-tax was 72 lakhs, in 1921-22 it amounted to not less than 347 lakhs. It should not be difficult to devise a method of a graduated rate similar to that which we have recommended in the case of income tax.

9. The Government of Bombay find it necessary to refer again to what they said in their letter last year in bringing to the notice of the Government of India the acute financial position of this province. Since then the Accountant General and the Auditor General have again commented on the inability of the Bombay Government to meet the whole of their statutory obligations from their ordinary net revenues. In revising the Accountant General's report, the Finance Department of this Government has come to the conclusion that they are working under a permanent revenue deficit of not less than 40 lakhs. Part of this will indeed disappear with the final remission of the provincial contribution, but the province will still be left with a deficit and with no margin whatever for the expansion of nation building activities. They cannot avoid the conclusion that the proposal of the Government of India to give a flat rate of 3 pies on personal assessable incomes, the total of which is so much less than the figure of total assessed incomes, is unlikely to prove satisfactory.

Statement showing personal income figures of Government of India, assessed income under Return III, Return IV and total assessed income.

	1923-24.				1924-25.				1925-26.			
	Personal income figures of Govt. of India.	Return IV.	Return III.	Total Return III & IV.	Personal income figures of Govt. of India.	Return IV.	Return III.	Total Return III & IV.	Personal income figures of Govt. of India.	Return IV.	Return III.	Total Return III & IV.
Madras	15,73	24,69	4,11	28,80	17,41	19,46	3,42	22,88	19,42	21,03	3,63	24,66
Bombay ...	40,53	39,30	18,83	58,13	40,05	39,58	9,62	49,20	40,60	39,08	8,86	47,94
Bengal	25,33	26,17	figures not available.		24,94	25,08	22,05	47,13	28,74	25,70	25,60	51,30
United Provinces ...	12,80	11,20	2,96	14,16	13,19	11,23	2,19	13,42	13,89	11,72	2,22	13,94
Punjab	7,62	13,47	90	14,37	9,11	12,31	67	12,98	10,15	12,95	1,06	14,01
Burma	10,08	11,90	6,89	18,79	10,83	14,51	7,81	22,32	13,25	15,92	8,54	24,46
Bihar and Orissa	6,62	8,04	18	8,22	7,20	7,92	28	8,20	7,45	7,80	20	8,00
Central Provinces	5,59	7,24	1,14	8,38	6,54	6,80	97	7,77	6,76	6,79	78	7,57
Assam	2,21	2,90	1,89	4,79	2,75	3,23	2,44	5,67	3,30	3,52	1,99	5,51
Total ...	1,26,51	1,44,91	71,45	2,16,36	1,32,02	1,40,12	49,45	1,89,57	1,43,56	1,44,51	52,88	1,97,39

FROM J. A. WOODHEAD, ESQ., I.C.S., SECRETARY TO THE GOVERNMENT OF BENGAL, No. 6681-F.R., DATED CALCUTTA, THE 7TH NOVEMBER 1927.

Readjustment of Revenue between Central and Provincial Governments within the Meston Settlement.

I am directed to acknowledge the receipt of your letter No. F. 11-XII—F., dated the 26th September 1927. The Government of India in Mr. Juke's letter No. F. 116 (V)-F.—26 of the 13th August 1926, acting on the recommendations of the Indian Taxation Enquiry Committee as to the theoretical correct distribution of the proceeds of taxation between Imperial and Provincial, made certain provisional proposals in connection with the transfer of non-judicial stamps to the Central Government and the re-imbursement to the provincial Governments of the loss in revenue sustained by that transfer. In view of the criticisms made and the objections raised to the scheme as then formulated, the Government of India have re-examined the subject, and in your letter under reference the opinion of the local Government is sought on the final proposals of the Government of India.

2. Before dealing with the specific proposals on which the opinion of the local Government is desired, I am directed to suggest that the sequence of events and the summary of the conclusions, as described and stated in paragraph 1 of your letter under reference, are not strictly accurate. The Sub-Committee of the Conference of Financial Representatives, held in November 1926, did not consider the objections raised to the original scheme and the alternatives proposed by provincial Governments in their replies to Mr. Juke's letter No. F. 116 (V)-F.—26 of the 13th August 1926. The Government of India had, prior to the Conference, revised their proposals in the light of the severe criticisms to which the original scheme had been subjected by the provincial Governments, and the Sub-Committee was appointed not to examine these objections and alternatives, but to examine certain questions arising out of the revised proposals of the Government of India as detailed on pages 3 and 13 of the proceedings of the Conference of Financial Representatives. It is not, therefore, strictly accurate to state, as has been stated in the letter under reference, that the Sub-Committee examined at considerable length the objections raised and the alternatives proposed by the provincial Governments. I am also to suggest that the conclusions which were embodied in a series of propositions did not emerge from the discussions of the Sub-Committee or the Conference. This series of propositions was placed before the Conference for the first time on the 17th November 1926, and it was understood that they embodied the views of the President of the Conference. They were discussed by the Conference, and, subject to very important reservations made by certain provincial Governments, were agreed to. General proposition No. 2, as agreed to by the Conference, laid down that it was desirable that a new formula should be found to replace Devolution Rule 15 of such a character as to give each province an interest in receipts from taxes on income which will reflect the growing prosperity of the province as measured by assessment. In summarising the

conclusions the letter from the Government of India omits all reference to this very important conclusion and elevates the proviso to general proposition No. 2 to the position of the chief characteristic of the new formula. It is true that general proposition No. 5 does not embody the main decision contained in general proposition No. 2, but one proposition cannot be divorced from the other; proposition No. 5 did not, and was not intended to override proposition No. 2, and all that proposition No. 5 did was to emphasise the fact that no province should be an actual loser by the formula which was to replace Devolution Rule 15. The local Government, therefore, direct me to suggest that paragraph 2 of the conclusions, as summarised in the letter under reference, fails to reflect the conclusion agreed to at the Conference, in so far as it does not mention the fundamental condition to be fulfilled by the new formula.

3. The local Government accept in principle the proposal that the stamp duties on the commercial documents specified in annexure A to your letter under reference should be transferred from the provincial Governments to the Central Government, and will raise no objection to the proposal becoming an accomplished fact, provided the financial rearrangements, which must inevitably accompany that transfer, are acceptable to the local Government. If the attendant financial changes are, however, such as cannot be accepted by the local Government, this Government will be compelled to object to the transfer of any portion of the revenue from non-judicial stamps from the provincial Governments to the Central Government.

4. Before proceeding to examine in detail the formula which it is proposed shall replace Devolution Rule 15, the Governor in Council desires to draw attention to the general financial results of the proposals now made by the Government of India, because he is of opinion, that, without proceedings into details, the general financial result is of such a character as to render it impossible for this Government to accept the new formula.

The net financial result of the proposed changes is the surrender by the Government of India of revenue amounting to Rs. 56½ lakhs for distribution among the provinces, and it is estimated that this total addition to provincial revenues will be divided among the provinces as follows :—

(In lakhs of rupees.)

Madras ..	1,46	Punjab ..	19
Bombay ..	22,70	Burma ..	14
Bengal ..	3,47	Bihar and Orissa	8,13
United Provinces	13,90	Central Provinces	7,14
Assam		—63	

The Government of Bengal have from the very introduction of the Reforms protested against the injustice done to the province by the Meston Settlement, and have, throughout the long correspondence on the subject, maintained that the remission of the provincial contribution, temporary or permanent, was only a palliative, and that nothing short of a thorough revision of the Settlement would remove that injustice and solve Bengal's financial problem. Although this has always been the attitude of this Government,

the Governor in Council has refrained from pressing for a revision of the Meston Settlement, formerly because of the financial difficulties of the Central Government and latterly because it was realised that any revision must be deferred pending the report of the Taxation Enquiry Committee and the abolition of the provincial contributions. The abolition of the provincial contributions is now in sight—the present proposals of the Government of India are dependent upon the final extinction of those contributions —and hence the proposed surrender of revenue amounting to Rs. 56½ lakhs by the Central Government for division among the local Governments must be examined by the Government of Bengal in the light of their claims to a thorough revision of the Meston Settlement. The financial difficulties into which Bengal was plunged as the result of the Meston Settlement are well known to the Government of India and were publicly admitted by Sir Malcolm Hailey in 1921, when he moved the resolution recommending the remission for the first time of the Bengal contribution. His words have been quoted in previous correspondence but they may be repeated again because they sum up in a few well-chosen words the financial plight of Bengal:—

"We have examined the case both narrowly and critically and it appears certain that with every economy Bengal must have a deficit of not less than Rs. 120 lakhs, even if we make no allowance for any extra expenditure on improvements in transferred subjects, such as are desired by Ministers—improvements which, we are told, are necessary if the system of the Reforms is to be a success. Bengal would have that deficit even if it provided only the bare minimum expenditure required to carry on the ordinary administration of the province."

The injustice done to Bengal is, therefore beyond question and the Governor in Council hopes that he will not be called upon to refute the suggestion that the permanent abolition of the provincial contribution—an advantage which will be common to all provinces—will in any way remove that injustice; that injustice will most certainly remain when all the provincial contributions have been extinguished. In these circumstances the Government of Bengal are of opinion that relief to Bengal should be treated as a first charge on any surplus revenue which may accrue to the Government of India after the extinction of the provincial contributions. The Governor in Council is, however, astonished to learn from an examination of the proposals of the Government of India that they do not intend to utilise their surplus revenue in relieving, even in a partial manner, the financial injustice under which the province of Bengal is suffering. A net increase in revenue to this province of Rs. 3½ lakhs is no relief worthy of the name; this, however, is not all, as against an increase of revenue of Rs. 3½ lakhs to Bengal, Bombay obtains a net increase of over 22 lakhs, the United Provinces nearly 14 lakhs, Bihar and Orissa over 8 lakhs and the Central Provinces over 7 lakhs. The scheme, therefore, instead of assisting towards the removal of Bengal's financial

difficulties, only increases the disparity of treatment by giving larger increases in revenue to other provinces. In view of the pronouncement of Sir Malcolm Hailey in 1921, of the history of Bengal's financial position under the Reforms, and of the consistent attitude adopted by the local Government towards the revision of the Meston Settlement, such proposals are not acceptable to this Government, and on these grounds alone the Governor in Council is obliged to decline to agree to them.

5. The new formula to replace Devolution Rule 15 must, in accordance with the propositions agreed to at the Conference of Financial Representatives of November 1926, fulfil two conditions :—

(*a*) It has to give to each province such an interest in the receipts from income-tax, over and above that required to balance the loss consequent on the transfer of the revenue from non-judicial stamps on certain commercial document to the Central Government and the abolition of certain assignments at present received by the local Government from Central revenues, as will reflect the growing prosperity of the province as measured by assessment.

(*b*) The minimum share obtained by each province must not be less than the assignment it would receive, or expect to receive, under Devolution Rule 15 as it now stands, *plus* the loss of stamp revenue and other assignments.

Devolution Rule 15 was introduced by the Select Committee of the House of Commons because it was recognised that the allocation of the entire receipts from the land revenue to the provinces and the entire receipts from income-tax to the Central Government would penalise the industrial provinces of Bengal and Bombay to the benefit of the agricultural provinces. Devolution Rule 15, therefore, was framed with the object of benefiting these two provinces and of giving to them shares in the income-tax receipts larger than those to be drawn by the predominantly agricultural provinces. Unfortunately, Bengal and Bombay are the only two provinces which have not benefited by Devolution Rule 15, whereas the other provinces, for whose benefit the rule was not introduced, have gained varying amounts of revenue. In short, Devolution Rule 15 has given nothing to those for whose benefit it was introduced and has benefited those for whose benefit it was never intended. The Governor in Council believes that the inequitable manner in which the rule has worked is beyond question ; but if further proof is required, reference may be made to the terms of reference by which the Indian Taxation Enquiry Committee were specifically asked to examine the working of Devolution Rule 15 and to Sir Basil Blackett's speech in the Legislative Assembly on the 7th March 1925. The primary object, therefore, of the substitution of a new formula for Devolution Rule 15 is the allocation to the important industrial provinces of Bengal and Bombay of a net share in the receipt from

income-tax commensurate with their commercial activities and with the revenue derived from income-tax and super-tax assessed on the profits from commerce earned within their borders. The words "net share" have been used intentionally and are interpreted as meaning the gross share of the receipts from income-tax, *less* the amount required to recoup the provinces or the loss of revenue consequent on the transfer of the revenue from certain non-judicial stamps and the abolition of certain other assignments. If the new formula does not produce this financial result, the formula is defective and should be rejected. The following figures give the net assignments from the income-tax receipts which the provinces are estimated to obtain on the basis of the figures for the two years 1925-26 and 1926-27 :—

	Net assignments from income-tax receipts according to the new formula.	Total gross collections in each province during the year 1925-26 on account of income-tax and super-tax.
	(*In lakhs of rupees.*)	
Madras	4,38	1,50,25
Bombay .	22,70	3,80,25
Bengal	3,47	6,23,79
United Provinces..	13,91	88,14
Punjab, including North-West Frontier Province ..	3,05	82,25
Burma .. .	7,55	2,22,19
Bihar and Orissa	10,61	41,86
Central Provinces	8,97	48,74
Assam	4,78	43,52

The Governor in Council is of opinion that the above figures approve beyond doubt that the new formula will not produce the desired financial result. A formula which, in view of the admitted relative importance from the industrial point of view of the provinces, gives the lowest assignment but one to Bengal and, as against Rs. 3½ lakhs to Bengal, gives Rs. 14 lakhs to the United Provinces, Rs. 10½ lakhs to Bihar and Orissa and Rs. 9 lakhs to the Central Provinces, stands self-condemned.

6. The Government of India admit that the initial benefit to Bengal is not very considerable. The local Government consider that this is an understatement of the case, but take it as an admission that the Government of India appreciate that the immediate financial result of the formula will be inequitable to Bengal. The Government of India, however, do not consider that the inequitable character of the immediate result is fatal to the scheme on the ground that the improvement which the Central Board of Revenue expect to effect in the income-tax administration in Bengal, combined with a general improvement in trade, will enable Bengal to enjoy a much larger and increasing benefit from the proposed formula. The Governor in Council regrets that he must definitely disagree with the arguments used by the Government of India and would suggest that the equitable character or otherwise

of the new assignment should be judged solely on the basis of present day actuals and not on indefinite estimates based upon possible improvements in administration and a problematical improvement in trade. Further, in so far as the improvement in trade is concerned, the Government of Bengal fail to understand why Bengal should be expected to receive from improved trade an increase proportionately greater than that likely to be obtained by other provinces. On the contrary, compared with the province of Bombay, the exact opposite is the more likely result, as illustrated by the collection in Bombay and Bengal during the four years ending 1925-26—

INCOME-TAX.

(In thousands of rupees).

	1922-23.	1923-24.	1924-25.	1925-26.
Bengal ..	3,29,61	3,47,82	3,30,66	3,74,17
Bombay ..	5,08,91	3,98,55	3,10,12	2,91,87

SUPER-TAX.

(In thousands of rupees.)

Bengal ..	2,57,37	2,60,60	2,19,74	2,49,62
Bombay..	2,98,25	1,97,99	1,27,37	88,38

7. In paragraph 3 of the letter under reference the Government of India examine the manner in which the assignment from the revenue derived from income-tax should be distributed among the provinces and arrive at the conclusion that the only practical way will be to base the distribution on a flat rate on the personal incomes of the assessees from all sources. The possible methods of distribution were examined by the Taxation Enquiry Committee and they were of opinion that in theory the scheme of division should give due weight to the principle of origin as well as to that of domicile. The question of the relative weight to be attached to origin and domicile was examined by a committee of eminent economists appointed by the League of Nations and they drew up a classification as regards each category of wealth showing where the economic allegiance lay in a preponderating degree *vide* paragraph 534 of the Taxation Enquiry Committee's report. The Taxation Enquiry Committee made several attempts to devise a scheme based upon the classification prepared by the committee of eminent economists, that is, a scheme which would give the proper relative weight to origin and domicile. They, however, failed and came to the conclusion that the only possible method was to base the distribution primarily on the principle of domicile. The Committee did not attempt to justify this departure from theory on the ground that the financial result would still be equitable as between province and province; on the contrary, they appear to have been convinced that this departure would produce inequitable results because they recommended that, in order to give a *partial* recognition to the principle of origin, each province should be given small portion of the receipts of super-tax on the profits of companies. The local Government would draw particular attention to the use of the word "partial"

by the Committee, as it points to the conclusion that the Committee realised that their system, modified so as to give small portion of the receipts from the companies' super-tax to the provinces, was defective in theory in so far as it did not give full and proper weight to the principle of origin. The Government of India have examined the Committee's scheme and have come to the conclusion that it is impossible to give each province any share in the receipts from companies' super-tax, because, of the practical difficulties in making the preliminary adjustments of the collections of each province to meet the case of the profits earned in several provinces but taxed only in one, which are considered essential for an equitable distribution. The Government of India have, in view of these practical difficulties, abandoned all attempt to give the provinces a share of the companies' super-tax and have decided to effect the distribution solely on the principle of domicile, giving no weight whatsoever to the principle of origin. The scheme adopted by the Government of India, therefore, involves an even greater departure from a theoretical correct distribution than the scheme put forward by the Taxation Enquiry Committee.

8. The local Government understand that the Government of India do not attempt to claim that their scheme is theoretically and scientifically accurate; the Governor in Council is of opinion, however, that the scheme departs more radically from a theoretically correct distribution than a mere perusal of the letter from the Government of India would lead one to suppose, and he desires to draw particular attention to the fact that the scheme propounded by the Government of India suffers from the fundamental defect that it gives no weight whatsoever to the principle of origin. The Governor in Council is of opinion that it will not be possible to accept any scheme which involves important departures from theoretically principles until it is established that the financial results still remain equitable, in spite of the sacrifice of those principles. The local Government appreciate the practical difficulties in applying theoretical principles to the division of income-tax, but they cannot admit that the existence of these difficulties can justify the adoption of a system which will produce an obviously inequitable distribution. If practical difficulties compel a radical departure from theoretically correct principles, the financial effect of that departure should be examined on broad general lines and, if the result is obviously inequitable the system should be abandoned. The Governor in Council has dwelt on the inequitable character of the financial results in paragraph 5 of this letter and is of opinion that the inequitable result produced by the system proves that the system is too far removed from a scientifically accurate system to warrant its adoption.

9. The Government of India have rejected the proposal of the Taxation Enquiry Committee to give the provinces a share in the super-tax on companies, because they found it impossible to make the preliminary adjustments of the collections in each province to meet the case of profits earned several provinces but taxed only in one. The fol-

lowing figures give the gross collections on account of super-tax on companies in the provinces during the years 1922-23 to 1925-26 :—

	1922-23	1923-24	1924-25	1925-26
	Rs.	Rs.	Rs.	Rs.
Madras ..	16,76,980	23,55,661	15,34,873	15,14,711
Bombay ..	1,50,78,575	96,96,316	51,37,013	38,97,213
Bengal ..	1,22,06,241	1,29,83,059	1,20,16,398	1,40,12,570
United Provinces.	20,22,871	15,34,074	11,30,218	12,12,285
Punjab ..	2,99,457	5,20,917	3,86,382	4,93,427
Burma ..	39,34,672	44,46,371	43,48,547	50,38,068
Bihar and Orissa.	35,717	38,920	93,386	15,635
Central Provinces.	7,27,842	6,34,041	5,65,412	4,57,854
Assam ..	91,274	4,68,193	10,03,898	8,02,172

The collections in Bombay, Bengal and Burma are so large, as compared with those in other provinces, that the conclusion appears inevitable that, even allowing for adjustments conducted in a manner most favourable to the provinces in which income is earned though not taxed, these provinces would obtain the lion's share of any portion of the companies' super-tax which might be distributed and that the share obtained by the agricultural provinces would be very small. The decision of the Government of India, therefore, to withhold from the provinces any share of the companies' super-tax penalises very heavily the industrial provinces and weights the distribution unfairly in favour of the agricultural provinces. The Governor in Council is of opinion that this course is inequitable and should not be followed unless the practical difficulties are insuperable. The Government of India have decided that the preliminary adjustments are impossible, because these adjustments would have to be based on assumptions of an extremely hypothetical character. The local Government agree that it will be impossible to conduct the adjustments strictly according to scientific methods, but the Governor in Council is not satisfied that methods of adjustment, which will on the whole be fairly equitable, cannot be devised for practically all cases. Some cases may offer exceptional difficulties, but it is unlikely that the total income involved in these cases will be sufficient to upset the equitable character of the ultimate financial result. The Governor in Council is strengthening in this view by two circumstances. First, a working agreement has been arrived at between the Government of Bengal on the one head and the Governments of Assam and Bihar and Orissa on the other for the distribution of the profits of mining and tea companies. Secondly, the amount of income in the commercial provinces, as regards which there can be no doubt, is so large, as to render it unlikely that a rough and ready method of distributing the balance would render the ultimate result grossly inequitable.

10. The Government of India also considered the possiblity of giving the provinces the proceeds of a flat rate on personal incomes *plus* personal super-tax incomes, but decided that this was not desirable; not because the system afforded any practical difficulties, but because Bombay and Bengal would under such a formula lose instead of gain, owing to the fact that the initial pie rate would be lower if super-tax incomes were added to the ordinary incomes. This decision is said to be based upon actual statistical investigations. Unfortunately,

the statistical results of the investigations have not been given in your letter under reference and the local Government are, therefore, not in a position of offer any opinion on the decision arrived at by the Government of India. In view of the infinitsimal benefit likely to accrue to Bengal under the Government of India's scheme, the Governor in Council finds it difficult to appreciate how Bengal would be worse off.

11. The Indian Taxation Enquiry Committee recommended that the distribution should be made on a basic rate graduated proportionately to the general rate. The Government of India in their letter No F-116 (V)-F.---26 of the 13th August 1926, expressed the opinion that the adoption of a graduated rate would be inconvenient from the point of view of both the Central and the Provincial Governments, since it would create difficulties in the event of a decision to alter the rates or to adopt a new system of graduation and suggested the adoption of a flat rate. The local Government in their letter No. 1453-T—F.B of the 2nd October 1926, agreed to the suggestion of a flat rate. The Governor in Council has re-examined this question and after further consideration, has decided that a flat rate will be unsuitable as likely to penalise the commercial provinces and favour the agricultural provinces in the scheme of distribution Under the ideal system of distribution the amount allocated to each province should bear approximately the same proportion to the contribution made by each province by way of income-tax and super-tax to the Central revenues. So long, however, as income-tax and super-tax are realized at varying rates on different classes of income, it is obvious that the ideal distrbution will not be attained by a flat rate on incomes, because, the flat rate will favour those provinces in which incomes are on a generally lower level The statistics given at the close of this paragraph point to the conclusion that this bias will once again be in favour agricultural provinces and to the disadvantage of the industrial provinces and the Governor in Council finds it, therefore, impossible to accept the proposal of a flat rate. He is of opinion that if the industrial provinces are not to be penalised, it will be essential to adopt the proposal of the Taxation Enquiry Committee of a basic rate graduated according to the general rate—

1925-26

(In thousands of rupees)

	Total assessed income.	Gross collections. Income-tax.	Gross collections. Super-tax.	Total
Madras ..	25,45,51	1,27,35	22,90	1,50,25
Bombay .. .	51,08,08	2,91,87	88,38	3,80,25
Bengal	52,19,54	3,74,17	2,49,62	6,23,79
United Provinces ..	14,31,48	70,66	17,48	88,14
Punjab, including North-West Frontier Province ..	16,64,22	75,09	7,16	82,25
Burma	24,63,50	1,62,24	59,95	2,22,19
Bihar and Orissa ..	8,39,16	37,40	4,46	41,86
Central Provinces ..	7,90,95	38,73	10,01	48,74
Assam	5,61,84	35,25	8,27	43,52

12. The Governor in Council is of opinion that no scheme which fails to give due weight to the principle of origin will ensure an equitable distribution of the total assignment from income-tax. The

relative weight to be given to domicile and origin, and the exact manner in which effect should be given to any conclusions as regards this problem are questions of the greatest difficulty, but the local Government cannot agree that a solution of the whole problem of distribution can be obtained by brushing aside these difficulties and basing the distribution on a system which deliberately gives no weight whatsoever to origin.

Domicile and origin are most likely to diverge as regards the income from—

(*a*) companies ;

(*b*) registered and unregistered firms ;

(*c*) the interest on provincial and municipal loans.

The first two classes of income are of great importance to an industrial province, and the result of giving no weight to origin is to deprive an industrial province of all interest in the income-tax derived from that portion of the above classes of income which accrues to person not resident in the provinces and which represents the undistributed profits of companies. It is believed that the amount of this class of income is very considerable in the major industrial provinces, especially in Bengal. The following figures support this conclusion :—

(*In thousands of rupees.*)

	Total personal income : 1925-26.	Total assessed income 1925-26		Total
		Companies and registered firms	Other sources	
Madras ..	19,42,00	3,39,63	22,05,88	25,45,51
Bombay ..	40,60,00	7,15,52	43,92,56	51,08,08
Bengal ..	28,74,00	24,49,20	27,70,34	52,19,54
United Provinces.	13,89,00	2,04,51	12,26,97	14,31,48
Punjab, including North-West Frontier Province ..	10,15,00	88,42	15,75,80	16,64,22
Burma ..	13,25,00	8,40,32	16,23,18	24,63,50
Bihar and Orissa.	7,45,00	17,13	2,22,03	8,39,16
Central Provinces ..	6,76,00	75,63	7,15,32	7,90,95
Assam ..	3,30,00	1,99,10	3,62,74	5,61,84
Total ..	1,46,56,00	49,29,46	1,56,94,82	2,06,24,28

If the Governor in Council is correct in the conclusion that the amount of the income in an industrial province in which origin and domicile diverge is very considerable, there can be no doubt that any system of distribution which excludes all weight attributable to origin must very seriously penalise an industrial province like Bengal, and must be one which the Government of an industrial province cannot accept.

The figure of Rs. 60 crores, being the difference between the total personal income and the total assessed income for the whole of India, represents the undistributed profits of companies and the income on foreign capital invested in India by persons resident abroad and who have no agent in India. The greater part of the undistributed

profits of companies accrues in the industrial provinces and the system adopted by the Government of India has, therefore, the effect of unfairly excluding these provinces from all interest in the income-tax realised on these undistributed profits. The Governor in Council is aware of no reason why a province should suffer because the companies working within its borders adopt the policy of not distributing their entire profits. The greater part of the foreign capital, other than that invested in securities of the Government of India, provincial Governments and local bodies, is in all probability invested in commercial undertakings in the industrial provinces; and if no weight is given to origin, the industrial province is deprived of all interest in the income derived from this capital.

13. The Governor in Council accepts in principle the proposals of the Government of India with regard to the removal of the minor fiscal anomalies in connection with the Court-fees Act referred to in paragraph 5 of your letter, but would suggest that these proposals should not be given effect to until the main proposal in connection with the consideration of Devolution Rule 15 has been decided The local Government would also be pleased if the Government of India could furnish them with an estimate of the probable loss in revenue which is likely to accure to the local Government in consequence of the proposed changes.

14. The Government of India also consider it desirable to delete from section 39 of the Indian Forests Act of 1878 the power given to local Governments to levy import duties on articles of forest produce entering their territories from outside British India, unless such a course would cause serious administrative inconvenience, and ask that the administrative justification for the continuance of these import duties should be re-examined. No import duties of the character in question are levied in Bengal, and hence the Governor in Council is not in a position to offer any opinion on the degree of administrative inconvenience which may accompany the change in the law contemplated by the Government of India. His Excellency the Governor would, however, suggest that, as these import duties cannot be levied without the sanction of the Governor-General in Council, and as the revenue derived therefrom is small, no change should be made, if there is the slightest danger of the change being accompanied by increased opportunities of forest produce, removed from provincial forests, avoiding the payment of the royalties to which the local Governments are entitled.

15. In conclusion, the Governor in Council wishes to draw the attention of the Central Government to the serious political consequences which must inevitably follow the adoption of the formula proposed by the Government of India in place of Devolution Rule 15. Intense dissatisfaction with the financial position, as the result of the Meston Settlement, has dominated the whole political outlook in Bengal since the introduction of the Reforms, and in the opinion of the Governor in Council has added greatly to the difficulties experienced in working those Reforms. Further, the urgent necessity of an early revision of that

Settlement has formed the subject of resolutions tabled at almost every session of the Legislative Council. The admission of the Government of India that the revenue allotted to Bengal was not sufficient to carry on the ordinary administration of the province has naturally created hopes that the first revision of the financial settlement will take the form of the grant to Bengal of substantial financial relief designed to redress the injustice done by the Meston Settlement. If the first revision of the Settlement, on the contrary, gives no relief to Bengal, but favours other provinces which have already benefited greatly by the Meston Settlement, that announcement will be received by the people of Bengal with, extreme dissatisfaction and a serious political situation will arise. The Governor in Council can only contemplate with dismay the prospect of having to meet the Legislative Council on the publication of the scheme as now formulated by the Government of India, and has no doubt but that the activities of the Legislative Council in the exasperated state of mind produced by the announcement would be seriously enbarrassing to the local Government and to the Government of India.

LETTER FROM N. S. CROSTHWAITE, ESQ., C.I.E., I.C.S., M.L.C., SECRETARY TO THE GOVERNMENT OF THE UNITED PROVINCES, NO. B.-7205-X.-L., DATED LUCKNOW, THE 2ND NOVEMBER 1927.

SUBJECT.—*Readjustments within the Meston settlement.*

I am directed to reply to Mr. Brayne's letter No. F.-11/XII—F., dated 26th September 1927, on the above subject.

2. The main proposals consist of the transfer to the Central Government of stamp duties on certain specified documents which are of a commercial or quasi-commercial character, and the grant of compensation to provincial revenues in the form of a share of the income-tax at the rate of three pies in the rupee on personal assessable incomes from all sources of assessees resident within a province. The Governor in Council welcomes this change. He accepts the estimate of Rs. 7 lakhs as the loss due to the centralization of certain general stamps, and notes that on the average of the past two years the yield of the pie rate will exceed Rs. 21½ lakhs. There are however certain points which call for remark.

3. Annexure A to Mr Brayne's letter describes article 62(c) as "any interest secured by a policy of insurance, etc." That article deals with the transfer of any interest secured by a bond, mortgage deed or policy of insurance But in paragraph 1(1) of the letter the Government of India state that provinces will retain conveyances, mortgages, leases and other important revenue yielding items, which leads the Governor in Council to infer that there is an inadvertent error in describing article 62(c). That should read as follows :—"any interest securred by a policy of insurance;" and the point may be noted for correction when final action is being taken.

4. Under the new arrangement the Central Government will receive the revenue from embossing receipt forms. In the letter under reply however no mention is made of the charges on embossing, which clearly will become central with the transfer of this class of receipt. The Governor in Council presumes that the Government of India prefer that the existing arrangements for embossing should continue, the provincial government being reimbursed by central revenues the expenditure incurred, inclusive of a percentage for superior supervision.

5. When the changes are being brought into operation, the Government of India will doubtless issue detailed instructions to give effect to them. In the opinion of the Governor in Council a provincial government should continue to be responsible for the administration of the stamp law in its application to the instruments selected for transfer; and should therefore not only arrange for the supply of central stamps but also be responsible for detecting evasions of duty, for recovery of deficit duty and penalty, and for prosecution of offences against the stamp law in respect to central documents. In return for this service a provincial government should retain any deficit duty, penalty or fine that may be recovered through its agency. A separate agency will be uneconomical and less effective and will give rise to much public inconvenience. If however the Government of India do not accept this view and propose some other system for administering the Stamp Act in relation to the documents selected for transfer, the Governor in Council hopes that he will be consulted before a decision is reached.

6. As to the minor consequential changes this Government have no objection to offer to the following :—

(1) the abolition of the assignments under Devolution Rule 15 and other revenue assignments which are not in nature of payments for specific services rendered; and

(2) the amendment of the Indian Court-fees Act, 1870, with a view to the abolition of fees on all documents relating to proceedings before officers of the Income tax, Salt and Customs Departments of the Government of India.

There remains the suggestion that import duties levied under the Forest Acts on timber coming into a province from outside British India should be abolished. The remarks in the succeeding paragraph deal with this proposal.

7. In paragraph 6 of Mr. Brayne's letter the Government of India observe that the revenue from import duties amounted to an average of Rs. 38,000 in this province and suggest that the adminsitrative justification for their continuance should be re-examined. At the same time the Government of India consider it desirable to delete from the respective Acts the power given to levy import dues unless such a course would cause serious administrative inconvenience. The only produce that enters the United Provinces from outside British India is that which comes from Nepal into the Eastern circle, chiefly in the Gonda

and Bahraich divisions. This produce is admitted into the reserved forests on the issue of a pass, for which a nominal fee is levied. These fees, however, are not import duties, but are a necessary part of the procedure under section 41(c) of the Indian Forest Act. If forest produce (whether from a foreign country or a private forest) is allowed to pass through a reserved forest uncontrolled, it will be open to any one to misappropriate government forest produce and allege that it came from another source. Apart from the loss to provincial revenues, this will cause constant friction. Therefore to avoid friction and to safeguard provincial interests a system of passes and fees was introduced some years ago in agreement with the Nepal Darbar. The Governor in Council considers it esential to retain the present system to which no objection has been received from traders in the past ten years. The Government of India are under a misapprehension in stating that the income from import duties average Rs. 38,000 a year. That figure, evidently taken from the annual accounts, represents receipts under the head VIII-C—Revenue derived from forests not managed by Government (duty on foreign timber and other forest produce). The receipts, however, from the particular registration fees on Nepalese imports average only Rs. 406 a year and scarcely suffice to cover the expenses incurred.

LETTER FROM THE SECRETARY TO THE GOVERNMENT OF BURMA, FINANCE DEPARTMENT, No. 179-26, DATED RANGOON, THE 8TH NOVEMBER 1927.

SUBJECT.—*Re-adjustment within the Meston Settlement—Stamp Revenue and Income-tax.*

I am directed to reply to the Hon'ble Mr. Brayne's letter No. F.-11-XII F., of the 26th September 1927, inviting the opinions of Provincial Governments on certain proposals which are summarised in paragraph 7 of the letter.

2. The Governor in Council accepts proposals (1), (3) and (4) that—

"Stamp duties on the documents specified in Annexure A should be transferred to the Central Government";

"The assignments under Devolution Rule 15 and other revenue assignments, which are not in the nature of payments for specified services rendered, should be abolished"; and that

"The Indian Court Fees Act, 1870, be amended so as to abolish the fees on all documents relating to proceedings before officers of the Income-tax, Salt and Customs Departments of the Government of India".

3. The Local Government understands that the Government of India do not intend to apply to Burma proposal (5)—that "The import duties levied under the Forest Acts on timber coming into a Province from outside British India should also be abolised".

4. Proposals (2) and (6) deal with Income-tax. It is suggested that—

"(2) The Provinces should be given a share of the income-tax at the rate of three

pies in the rupee on personal assessable incomes from all sources of assessees resident within the Province"; and that

(6) If, in the case of any Province, the proceeds of the three pie rate are less than the loss of revenue from (1), (3) (4) and (5), the difference should be made good by means of an assignment from Central Revenues until the question of the future financial relations between the Central Government and the Provincial Governments is settled after enquiry by the Statutory Commission".

The statement marked Annexure B which is appended to Mr. Brayne's letter indicates that, taking the average of the personal incomes assessed to income-tax in Burma during the two years 1925-26 and 1926-27, the application of the proposal would involve an assignment of Rs. 19,55,000 or Rs 14,000 more than the sum of the Government of India's estimate of the receipts from stamps which it is proposed to centralise and the average of the last two years' assignments under Devolution Rule 15. The Government of India were informed in this Government's telegram of the 25th April 1927 that it was impossible to give even an approximate estimate of the revenue from the former source; His Excellency in Council is therefore unable to form any opinion regarding the adequacy of the estimate of Rs. 12 lakhs on which the Government of India have based the calculation Further he is not clear how the Central Government have arrived at the figure (Rs.7,41,000) which appears in the statement as the average amount of the assignment for the last two years under Devolution Rule 15. If the two years referred to are the years 1925-26 and 1926-27 the average is Rs. 11,58,603 as shown by the calculation below or Rs. 4,17,603 more, and the assumed benefit of Rs. 14,000 to Provincial Revenues is converted into a loss of Rs. 4,03,603. Under proposal (6) the Government of India will make good this difference by means of an assignment from Central Revenues "calculated on the figures of the last three years".

	Rs
1925-26	9,37,678
1926-27	13,79,528
Total	23,17,206
Average	11,58,603

5. The following table shows for each of the last five years since Devolution Rule 15 came into force, the total receipts in Burma from non-judicial stamps and the amount of the assignment under Devolution Rule 15 :—

Year	N. J. Stamp Receipts.	Devolution Rule 15 Assignment.	Total.
	Rs.	Rs.	Rs.
1922-23	24,99,959	..	24,99,959
1923-24	26,83,823	38,000	27,21,823
1924-25	30,38,801	5,96,440	36,35,241
1925-26	34,13,178	9,37,678	43,50,856
1926-27	33,05,562	13,79,528	46,85,090

The entries in column 2 exclude the payments made to the Rangoon Development Trust on

account of the additional stamp duty levied in the case of instruments affecting immoveable property situated in the city of Rangoon under Section 68(1) of Burma Act V of 1920. The figures show a rapid rate of increase under both heads despite a drop in the last year in the receipts from stamps and there is no reason why the increase should not continue. So far as Burma is concerned the proposals remain open to the objection detailed in this Government's letter No. 179-N./26 of the 8th November 1926 and no fixed assignment would be acceptable which did not make allowance for this fact. The average of a series of years is suitable where the question is one of determining the mean of a number of fluctuating quantities, but where the question is one of compensating a Provincial Government for a progressively increasing benefit which it is desired that it should surrender, the figure to be adopted should exceed the total of the latest years for which figures are available by a reasonable estimate of the probable loss for the future.

6. In paragraph 4 of Mr. Brayne's letter it is remarked that the comparatively large assignment which Burma has received under Devolution Rule 15 has followed not from any marked expansion of non-agricultural income but from the fortuitous circumstances that until a comparatively recent date there existed no properly organised machinery for the assessment of income-tax outside Rangoon city, and that the increase has been due to the extension of the activities of the Income-tax Department to the moffusil districts. The Government of India admit that in the case of Bengal the standard of income-tax assessment is much lower than it ought to be and there seem to be grounds for believing that Bengal would have derived some benefit from the Rule as it stands had the standard of administration been higher. The improvement of the efficiency of the income-tax administration in Bengal which the Central Board of Revenue are contemplating will enhance the benefit which that Province will derive from the application of the proposal under contemplation. In Burma where the assessment of income-tax has reached a considerably higher degree of efficiency there will be much less room for the expansion of revenue consequent on better methods of assessment and the substitution of the proposed assessment for the provisions of Devolution Rule 15 will, so far as can be seen, be a change for the worse. It is pointed out in paragraph 4 of this Government's letter of the 8th November 1926 that Burma is exploited to a much greater extent than obtains in the other major provinces in India by aliens—Europeans, Chinese and residents of other provinces of India—with the result that a fluctuating rate of income-tax on personal assessable incomes from all sources of assessees resident within the province is inevitably less favourable to Burma than it is to provinces otherwise situated. His Excellency in Council, however, realises that the exceptional circumstances of this province cannot be allowed to stand in the way of such a modification of Devolution Rule 15 as will benefit all other provinces in India with the exception of Assam; he is therefore prepared to concur in the application of the proposals to Burma on the understanding that in determining the amount of the

contemplated fixed assignment the Government of India will take into account the progressively increasing benefits which the Province now enjoys under the provisions of Devolution Rule 15 and that it will give sympathetic consideration to the substantial grievance which evoked this Government's representations in respect of the export duty on rice and the inclusion by the Meston Award among the Provincial Receipts of the revenue from the Capitation and Thathameda taxes which have been classed as sources of local revenue.

7. In view of the uncertainty of the estimates on which the calculations in Annexure B to your letter are based His Excellency in Council presumes that the Government of India will be prepared to revise the amount of the fixed assignment if experience shows that it was fixed too low.

LETTER FROM H. M. PRICHARD, ESQ., I.C.S., SECRETARY TO THE GOVERNMENT OF ASSAM, FINANCE DEPARTMENT, No. 7404-F., DATED SHILLONG, THE 10TH NOVEMBER 1927.

SUBJECT :—*Readjustments within the Meston Settlement.*

I am directed to refer to your letter No. F.-11-XII-F., of September 26th, 1927, on the subject of readjustments within the Meston Settlement and to say that the Governor in Council has no objection to the proposals summarised under heads (1), (2), (3), (4) and (6)—except in so far as head (6) refers to head (5)—in paragraph 7 of your letter.

2. The proposal summarised under head (5) is explained at length in paragraph 6 of your letter in which the Government of India refer to the import duties levied under various Forests Acts and propose to abolish the powers given to local Governments to levy such import duties on forest produce entering their territories from outside British India, unless such a course would cause serious administrative inconvenience. They, therefore, suggest that the administrative justification for the continuance of the import duties should be re-examined. The following figures give the revenue shown in the forest accounts as import duty during the last five years in this province :—

	Rs.
1922-23	49,485
1923-24	54,466
1924-25	68,073
1925-26	58,195
1926-27	43,190

These figures, however, by a mistaken classification include the royalty paid on limestone quarried in non-British territory in the Khasi and Jaintia Hills district. These receipts are not in fact an import duty. They represent the half share of the profit which is due to the Government under the terms of the agreements subsisting between the Government and the several Khasi States concerned. By the terms of these agreements all the lime, coal and other mines, metals and minerals in the Khasi States concerned are ceded to the Government on condition that the States concerned receive

half the profits arising from the sale, lease or other disposal of such lime, coal or other minerals. The total revenue derived from this royalty on limestone from non-British territory in the Khasi Hills during the past five years was as follows :—

	Rs.
1922-23	20,574
1923-24	23,408
1924-25	22,430
1925-26	21,249
1926-27	10,832

As this revenue has nothing whatever to do with import duties, it must be deducted from the total figures of import duties shown in the forest accounts. The revenue from import duties proper will, therefore, be :—

	Rs.
1922-23	28,911
1923-24	31,058
1924-25	45,643
1925-26	36,946
1926-27	32,358

Almost the whole of this revenue is derived from forest produce from the Khasi States. It is assessed on such produce exported into British India at half the Government rates of royalty imposed on similar produce derived from British territory. This duty has been levied for many years. Originally it was not regarded as an import duty. Under the agreements subsisting with the several States concerned all waste lands which the British Government may wish to sell or lease as waste lands are ceded to the British Government on the condition that the State shall receive half the profit arising therefrom and it was originally held that this clause gave Government the right to royalty on forest produce from the Khasi States, the royalty in practice being fixed at half the rates of royalty paid on similar produce in British territory. In 1904, however, the Chief Commissioner of Assam took the view that the terms of the agreement did not warrant Government in levying royalty upon such forest produce and he ordered that the levy should in future be treated as an import duty on such produce on its entry into British territory. Legally, therefore, the revenue derived from this source is an import duty. Although the levy of such an import duty by this Government may be technically an encroachment on the fiscal sphere of the Central Government there are circumstances which, in the opinion of the Governor in Council, justify the retention by provincial revenues of the import duty recovered from the Khasi States. The cost of administering these States, as far as it falls upon Government is borne entirely by provincial revenues. By the terms of the agreement these States are subject to the orders and control of the Deputy Commissioner of the Khasi and Jaintia Hills district ; certain classes of cases are reserved for the jurisdiction of the British Courts ; the excise control is exercised by the Deputy Commissioner and his staff, and various miscellaneous duties in connection with the administration of these States are performed by these officers and officers of other Government Departments. The exact amount of expenditure incurred on such work

by the provincial revenues cannot be given but it can safely be said that a large proportion of the cost of the establishment of the Deputy Commissioner and his office, and of the police, medical, public works and other services in the district, exclusive of the headquarters establishments in Shillong, is incurred on account of the administration of these States. In equity, therefore, the revenue derived on forest produce exported from these States should be assigned to provincial revenues. The business in forest produce and particularly in timber, in Assam is developing rapidly; and a fixed assignment based on past actual receipts from the duty would not adequately compensate the province for the loss of a source of evenue which has considerable scope for expansion. Whatever decision be arrived at on the question whether these receipts should be treated as provincial or central, the duty now imposed should undoubtedly be continued in some shape or form. It has for many years been accepted by the Khasi States as a normal incidence of their relation with the Local Government and it forms a useful contribution towards the cost incurred by the Local Government in connection with the administration of the States and the preservation of law and order therein. Apart from these considerations the retention of the duty is necessary in the interest of the forest administration both of British territory and non-British territory. If the duty now paid on forest produce imported into British territory were removed, the forests in the Khasi States would probably be ruthlessly denuded of timber and there would be a serious danger that timber from British territory would be passed off as timber from non-British territory a malpractice which it would be very difficult to check and which would adversely affect the provincial revenues.

The revenue derived from import duties on forest produce exported from places other than the Khasi States is of trifling amount. The figures for the past five years are as follows :—

	Rs.
1922-23	279
1923-24	193
1924-25	194
1925-26	183
1926-27	315

These fiugres are so small that the loss of revenue that would result from the abolition of the duties would be negligible. But here again the danger, that has been mentioned at the conclusion of the preceding paragraph, would arise, though perhaps not to such serious extent as in the case of the Khasi Hills. For these reasons the duties should be retained, but the justification for retaining for provincial revenues the revenue derived therefrom, which has been urged in the case of forest produce from the Khasi Hills, would not apply in the case of forest produce from other non-British territories.

EXTRACT FROM THE PROCEEDINGS OF THE CONFERENCE OF FINANCIAL REPRESENTATIVES HELD AT NEW DELHI IN NOVEMBER 1927.

Readjustments within the Meston Settlement.

It was observed that the whole of the Meston Settlement would come under examination by the Statutory Commission before long, and pending this examination only three Governments out of nine were in favour of proceeding with the scheme of the Government of India, five were in favour of postponing and Bombay was in favour of the matter being proceeded with only under certain stipulations.

APPENDIX III.

Division of Income-tax in Germany—Principles on which the tax is apportioned.

(1) A South Sea trade and plantation company. Head Office in Hamburg. The chief agency and plantation in Samoa, which is a German Protectorate. The board of directors, and superintendence at Hamburg. Most of the buying and selling is done at Samoa, but part at Hamburg:—

25 per cent. of the total income is taxed at Hamburg.

(2) A German Portland cement company, with its chief office and administration in Hamburg, but its factories in Prussia:—

Income from land falls to be taxed in Prussia. Of the balance Prussia claims 75 per cent. and Hamburg 50 per cent.

In the result they split the difference, and Hamburg gets 37½ per cent. and Prussia 62½ per cent.

(3) A Retail Business with many Branches.—A limited liability company. Chief office and management and part of the buying for the branches in Hamburg.

Hamburg took 20 per cent. for the chief office, administration, and part of the buying, of the balance a division was made on the basis of the turnover, the turnover in foreign branches being included in the Hamburg figure.

(4) Petroleum company. Head office, management, docks, and buying in Hamburg. Selling in Hamburg and the other States of Germany.

Of the total income 40 per cent. is taken for Hamburg on account of the chief office, etc. The balance is divided according to the respective turnovers.

(5) A cash register company. Chief office in Berlin, but wholesale warehouses, showing samples, in Hamburg.

A division was made according to the wages paid in the respective States.

(6) A brewery company with branch establishments in Hesse and Prussia. Division according to turnover.

(7) Chemical works with factories both in Baden and Prussia. In this case separate books were kept, and these accepted for the purpose of a division.

(8) Railway in both Prussia and another German State. The head office and administration in Prussia. The lengths of line in Prussia and the other State were in the proportion of 16:9, but the amount of money taken in the other State was greater than the amount taken in Prussia.

In the division 10 per cent. is taken for management in Prussia, and the balance divided equally.

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